S. HRG. 98-56—PART 2

GOVERNMENT MANAGEMENT OF NATURAL GAS IMPORT ISSUES

HEARING

BEFORE THE

SUBCOMMITTEE ON ENERGY, NUCLEAR PROLIFERATION, AND GOVERNMENT PROCESSES

OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

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GOVERNMENT MANAGEMENT OF NATURAL GAS IMPORT ISSUES

FRIDAY, JULY 29, 1983

U.S. SENATE,
SUBCOMMITTEE ON ENERGY, NUCLEAR PROLIFERATION, AND GOVERNMENT PROCESSES,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, D.C.

The subcommittee met, at 10:10 a.m., in room SD–562, Dirksen Senate Office Building, Hon. Charles H. Percy (chairman of the subcommittee) presiding.

Present: Senator Percy.

OPENING STATEMENT OF SENATOR PERCY

Senator PERCY. I don't ordinarily go to the wrong hearing room, but I went to the regular Governmental Affairs hearing room, not looking at my calendar carefully enough, and took with me a very special person. Mabel Detwiler is the former cook at Eureka College in the great State of Illinois and a friend of the President. She was there in the dormitory and was his guest at the White House yesterday and again on a tour of the White House this morning. So, Mrs. Detwiler, we are very happy to have you here.

Last winter, hard-pressed consumers across Illinois and other parts of the Midwest faced severe jumps in their gas rates. It is summer now, a time when gas bills are not ordinarily a major concern to Illinois consumers, but this year is different. I had testimony from Mabel Detwiler in my talks with her. Everyone is talking about their gas bills, and she is talking about hers. I am amazed at how many people still come up to me to talk about rising gas prices. And I know I will have that experience at the county fairs this weekend in Illinois. Rising utility rates have affected everyone—businesses, the elderly, the unemployed, and young families trying to live on tight budgets. Consumers deserve relief. I share their frustrations. I am squarely on their side. It is my duty and responsibility. I am going to wage this battle until we find a fair and reasonable solution. It must be fair to both sides. It must be fair to producers to make certain they have the incentive for production. It must cover their cost. We can't expect them to work below cost. We certainly expect a reasonable balance between the marketplace, consumer, and producer. In this case, we must find a more equitable solution than we have today.

Last fall, consumers throughout Illinois began paying for imported Canadian gas. In March, consumers in the central and southern part of the State began paying for imported liquefied natural gas at prices almost three times that of domestically available gas. At a late winter hearing of this subcommittee, representatives from Illinois businesses, utilities, residential consumers, and the Illinois Commerce Commission testified unanimously about the absurdity of the situation. We had a cross-section of everyone affected. Everyone agreed that something had to be done to curb these unreasonably high-priced natural gas imports.

Five months have passed since the hearing, and a number of events have occurred. Canada has begun to realize that its border price is too high. I have met with and had good conversations with three or four different groups of Canadians in all aspects of gas trade—the government, the producers, and so forth. In April, Canada announced a reduction in the border price from $4.94 to $4.40. Then, last month, Canada announced that for special incremental purchases of gas they would reduce the price to $3.40. This latter figure amounts to a 31-percent cut from the original price. In effect, the Canadians are acknowledging that the $3.40 price is closer to fair market value for imported gas. But before U.S. pipelines can buy this lower priced gas, they still have to buy large volumes of overpriced gas.

This points to the need to clarify the role Canada wants to play as a future gas supplier to the United States, as I have emphasized in my talks with them. We need to look at the long haul. We want to look to Canada as a long-term, reliable supplier, but that means we have to have equity as we move along. Under special circumstances, to meet peak period needs only, customers are sometimes willing to pay a bit more for gas. This could be the case, for instance, in a particularly cold winter month when demand is much higher than usual. Under these conditions, a somewhat higher than normal price for Canadian gas may be acceptable as long as—and I want to emphasize this—United States pipeline are not obligated to continue to buy this higher cost gas during normal periods.

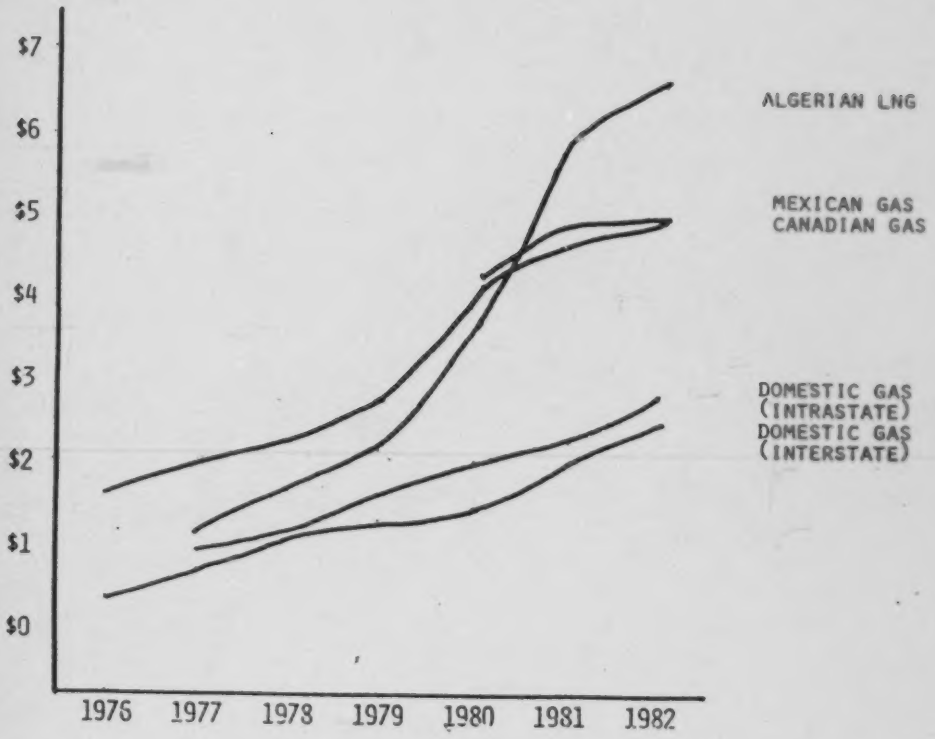
On the other hand, if Canada instead wants to serve our everyday—or baseload—demand, then it will have to reduce the price for all its gas to fair market levels. And that is all we ask, a price at fair market levels.

Let's look at the chart. We can see in this chart that even with these most recent reduction in the border price, the gap between the price of domestically available gas and Canadian gas remains quite high and quite large.

[The charts referred to follow:]

DOMESTIC VS IMPORTED GAS PRICE

(U.S. $ PER MILLION BTU)



DATA SHOWN ARE AVERAGE PIPELINE ACQUISITION PRICES

SOURCE: DATA RESOURCES, INC.

DOMESTIC VS IMPORTED GAS PRICES

(U.S. $ PER MILLION BTU)

	1976	1977	1978	1979	1980	1981	1982
DOMESTIC (INTERSTATE GAS)	.43	.68	.82	1.20	1.48	2.06	2.50
DOMESTIC (INTRASTATE GAS)	-	.79	.91	1.50	2.04	2.26	2.82
CANADIAN GAS	1.64	1.95	2.15	2.56	4.23	4.73	4.92
MEXICAN GAS	-	-	-	-	4.32	4.91	4.92
ALGERIAN LNG	-	1.05	1.50	1.99	3.70	5.94	6.56

DATA SHOWN ARE AVERAGE PIPELINE ACQUISITION PRICES

SOURCE: DATA RESOURCES, INC.

Senator PERCY. This chart even more clearly shows how overpriced LNG still is. Under current contract conditions, there would be a slight but barely noticeable dip in the price curve for LNG. Yet, this LNG continues to flow. Two weeks ago, the Trunkline LNG Co., the Panhandle subsidiary that imports this LNG, announced a new agreement with Sonatrach, the national oil and gas company of Algeria. I do not look upon the terms of this agreement as acceptable. I, as a businessman, would never come back home and applaud our efforts with that kind of a deal. I consider it much too one-sided. It is a bad deal for U.S. consumers. And I say so unequivocally. It will save Illinois consumers little, if any, money. In come respects, it may even cost them more.

Shortly following this announcement, the Federal Energy Regulatory Commission issued a show cause order to Trunkline. Under this order, Trunkline must report back to the FERC by next week, responding to why the FERC should not revoke Trunkline's certificate to import this LNG from Algeria.

Likewise, the Department of Energy's Economic Regulatory Administration just this week announced plans to review its criteria for granting import licenses. I am pleased these two agencies are now talking this problem seriously, but I shall not rest unti I see real relief for Illinois consumers and consumers of other neighboring States in the Midwest. Every day that passes without action, consumers in Illinois and other parts of the Midwest continue to pay for this outrageously priced gas.

We are very pleased to have a series of witnesses today that I think will shed considerable light on this problem.

Before our first witness appears, Natural Gas Pipeline Co. of America, I want to mention that I had extended an invitation to Panhandle Eastern Co. to testify as well. Panhandle is the pipeline which brings this high cost LNG into central Illinois. I and otners in the Congress have raised questions about Panhandle's actions, and I wanted to give the company the chance to present its case before the Congress.

After I invited Panhandle to testify at this hearing, and after that invitation had been accepted, the FERC issued a show cause order on the matter of the Trunkline contract. This prompted Panhandle to ask that it be excused from testifying. It would have been simple and straightforward to insure that Panhandle's appearance here today would not have interfered with its right in this case. However, we must be sure that all parties to this action, including Panhandle, have total confidence in the fairness of those proceedings. For this reason, and in light of the show cause order, I have granted Panhandle's request to be excused from the hearing this morning.[1]

Mr. Louis A. Lawrence, assistant vice president of planning, Natural Gas Pipeline Co. of America, Chicago, Ill., is our first witness.

Mr. Lawrence, we are particularly pleased to have you here to testify before the subcommittee. Natural Gas Pipeline Co. provides over two-thirds of all natural gas provided to my State of Illinois. We are indeed fortunate to be able to buy such a large amount of gas from the company with the lowest average price of any major pipeline in the United States.

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[1] See p. 59 for an exchange of correspondence and a prepared statement from the Panhandle Eastern Pipe Line Co.

At our February hearing, we heard from Mr. Morrow, president of Natural, who explained the problems Natural was facing in regard to natural gas imports from Canada. Since our February hearing, I understand that Natural has had a great deal of contact with Canadian suppliers and that you, as the assistant vice president of planning for Natural Gas Pipeline, have been directly involved in these discussions. Therefore, I believe your comments will be particularly useful to this subcommittee in understanding where we have come on natural gas imports and what actions still remain to be taken.

We welcome your comments. Your full testimony will, of course, be incorporated in the record as submitted to the committee. You are free to summarize.

TESTIMONY OF LOUIS A. LAWRENCE, ASSISTANT VICE PRESIDENT OF PLANNING, NATURAL GAS PIPELINE CO. OF AMERICA

Mr. LAWRENCE. I would like to summarize. But, first, I would like to say it is particularly timely, because yesterday I was in Calgary. We met separately with many of the parties that have an interest in this matter on the Canadian and pipeline side. So I believe that I can provide more than is in my written statement as provided to you on Wednesday.

We are pleased with your notice that we have some of the lowest cost gas in the country. I want to stress to you that that has been our corporate objective. It is the sum of all the actions we have taken, whether they are on the domestic front or foreign front. We have tried to assure adequate supply to our consumers during periods of curtailment. Now we have the adequate supply. We have reduced our imports from Canada. We have taken other actions on the domestic front to keep our prices low, and I think we will get around later to talk about what we expect in the future. But I want to stress to you that that is what we are about in Canada, and Canada is a part of our overall actions to maintain low cost.

During the 1970's curtailment, we made substantial investment in payments to find what is now low-cost gas. We have been told by others we were lucky, fortuitous, we have received an inheritance. And we reject such allegations because they are the direct response to the management approach and its concern about what it is that the consumer is paying. We are going to continue that.

With respect to Canada, I would like to emphasize what we have told you, what Mr. Morrow told you at that time. We do not believe that government-to-government regulatory bodies should set prices. We believe that the buyers and the sellers should set the price. We believe that governments should look over the shoulder of that and look at the national policies and points of view. We do not believe formulas work. We have a long history on this side of the border of how formulas have not worked. I think we have seen some effects in how Canadian gas is priced today to the formula failure approach. We stress again, buyers and sellers negotiate unique to their circumstances.

There are three issues and you have identified them all. No. 1, Canadian gas is today high priced. If we could take advantage of the plan that the Canadians have introduced, we would find that if we bought

all the gas available to us it would have an average cost of $3.90. Today, our average cost of gas, including the portion of Canadian that we are buying, is $2.54. There is no way on the base price of $4.40 or on the margin price of $3.40 or on the average price that we could agree with the Canadians they have done anything to help. What they have shown is they recognize there is a problem.

The second issue is, given the gas is too high priced, then why would a company such as ours, or anyone, increase and take larger volumes of such supplies, and, in fact, then what happens when we do not, when we enter into the take-or-pay problems? These problems are hitting all United States importers of gas from Canada, to my knowledge.

But there is a third key point. As we deal with price and as we deal with take-or-pay, you must keep in mind that the supplies are imported by us, that they augment domestic supply, and did during the 1970's. They were important during the seventies.

Given those three points, we have made a proposal and we have placed a stress on price in dealing with the Canadians and asking for other relief.

I would be pleased to answer any questions that you would have about that particularly as best I can.

Senator PERCY. Thank you very much indeed.

Before I get into the particulars of your dealings with the Canadians, I think it would be helpful to the subcommittee to get a general picture of Natural's gas cost beyond what you have already said. Consumers in Chicago and surrounding areas faced about a 17-percent increase in their gas rates last winter. These are consumers served by distributors which you supply and most of these cost increases were due to gas costs Natural passed through to them.

Consumers in Illinois feel they have faced enough price hikes. They are cognizant of what the President is doing to hold down inflation. They are cognizant of the fact that inflation overall was nine-tenths of 1 percent on an annual basis for the first 3 months of this year, with the exception of utility prices, and that is what really is causing consternation throughout the State, particularly with respect to gas prices. We were really lucky last year with weather conditions much milder than average. No one can predict this coming winter's weather, but perhaps we can get a better handle on what rates consumers will see on their bills through the winter months.

Can you give us some predictions on what rates consumers will pay in the areas supplied by Natural Gas Pipeline? Again, let me stress my hope that consumers in Illinois can be saved from what appears to them to be ever-spiraling gas costs.

Mr. LAWRENCE. Mr. Chairman, I think they can take some assurance. We currently project and have already placed on file with the Federal Energy Regulatory Commission last week our purchase gas adjustment cost. What it will be is a reduction of not quite 4 cents on the cost of gas we are purchasing and supplying to the consumers you have identified. There are better than 2.6 million residences using gas in Illinois, and many of them are served by Natural's customers, and we have looked at keeping those rates low. But the cost of gas is only one thing and we have been able to take some steps to do that. What I would like to do is put it in terms of what the consumer may expect.

We believe we can maintain the city gate price, which is the cost of gas which we deliver to the distributor on the city limits for the distributor to then take on into the city, that next winter the consumer will face rates which will be substantially no different than the rates that they paid last March, April, spring, summer. What we are saying is a sharp reversal of the trend you have identified. Now, these are what we are currently projecting. We have actions as yet untaken. This includes some of what we can accomplish with Canada, what we can accomplish in the States with domestic producers which will perhaps be able to allow us to insure that occurs. But I can't make that statement of assurance now. I can state what we currently are projecting based on what we know and what we have done.

Senator PERCY. If I understand you correctly, it looks like there is going to be good news for gas consumers in Illinois next year. This means, then, that Illinois consumers served by your pipeline—Chicago, for instance—will not really face and you do not anticipate they will face rate increases throughout the winter months, then?

Mr. LAWRENCE. This fall we will place into effect a filing that has already been on file. It was filed last spring as a result of the very warm winter we suffered, as a result of some substantial loss of sales that we have incurred, and that addresses the issue of the recovery of fixed cost to keep Natural Gas a viable organization. Our rates have been low in the past because we have made realistic and representative rate filings. This one is also that way and we are making every effort we can to get that settled. When I make the statement about the rates next winter, I am taking that rate increase into account.

Senator PERCY. I am extremely pleased to hear that, and I know that millions of families will be pleased to hear that also. We can't hold you responsible for the weather. All we can do is hope and pray that we are not going to have a severe, harsh winter next year. But if we have relatively mild weather, it means real relief for individuals in Illinois, and that is good.

Although I am pleased that prices will not go up this winter, I am concerned about what could happen over a period of time. Now, is it possible for you to look ahead a little bit? Could you tell us how you were able to stabilize your gas cost and what problems, if any, you will continue to face in keeping these costs down after the winter months? You might also want to indicate how your costs compare to other pipelines.

Mr. LAWRENCE. Senator, we have taken many actions. I hate to use a trade term called market out, but it is a phrase we use. What it amounts to is in certain contracts, particularly the new ones involved with higher priced gas, we have the right to tell the producer the price is too high and we offer him a lower price which he may accept or reject. We have exercised three rounds of these market outs. Currently, on those producers, we have told them we will pay you no more than $2.94 including taxes and all other adjustments. We have adjusted supplies. We have cut back significantly on Canadian imports. We have done all we can do within the limits of our contracts with our producers and will continue to do so to keep the cost down.

And I want to tell you that although inflation has been certainly mitigated and is very low, it is one of the problems that causes the cost of gas to rise because the NGP allows for escalation, and we are quite relieved to see the rate of escalation reduced.

In this context, there is something else I must say. We talk about what we have been able to do, and I am talking about the things under our control. There is one thing on the horizon that is not under our control. I am speaking, sir, specifically about the Senate energy bill, as I understand it was reported out. That offers severe threat to any consumer served by Natural Gas Pipeline, particularly all of those in the State of Illinois. What I am saying is this: There is a proposal that if old gas, of which we have a great deal, is suddenly allowed, on a gradual basis, to ramp up, that something magical will happen and nothing will occur. I stressed to you earlier this old gas is something that was not fortuitous or luck. It was what we had accomplished with a diligent effort. It appears that is going to be taken away from us and, therefore, away from the consumer we serve. What I am talking about is, if the provisions of the bill, as I understand them—I have not seen the final amended bill—were to be put into place as we understand it, consumers of Illinois and other consumers served by us would see an increase of $2 to $2.5 billion in gas costs over the next 8 years.

Now, that number is very large, but what does it mean? It means when I talk about our cost of gas and delivering it to the city, that we would see something between 15 and 20 percent per year increases in gas costs. And that is beyond our control.

When I am saying we are doing all we can do, we will meet with anyone to show them what we believe the error of that bill is. We will work with you or whoever. But we do need some help, and we seek your help.

Senator PERCY. I appreciate very much your laying this right on the line. There had been some information put out to the contrary. You are in the business, you are close to it. Now, what you are talking about, and the figures you have given are absolutely startling, they would just wreck in a sense the program that we have worked on for 2½ years to bring down inflation, bring down costs, make our wages meaningful to our people. This would literally terrify older people who live on fixed incomes and who can't turn their thermostat down in winter and need to have comfort if they have air-conditioning in the summer. So we have got to do something, and I intend to see that we do everything we possibly can.

Mr. LAWRENCE. I would be glad to assist in that.

Senator PERCY. We will work very closely together on it.

We both met with the Canadians. We found them understanding and we worked closely with them. Since this subcommittee's hearing in February, the Canadians have taken a number of actions, as we indicated, related to their gas export policy. They have reduced the border price, as you mentioned in your statement. More recently, they announced that for large purchases of Canadian gas they will reduce the incremental price to $3.40. They call this an incentive rate. You seem to indicate on pages 6 and 7 of your statement that these changes have made little or no difference in terms of your gas costs and purchasing practices. Is that correct?

Mr. LAWRENCE. Yes, sir, it is, because we would first have to increase our takes from Canada at the price of $4.40 so that we would then be eligible to be on the downside of the curve to purchase additional gas at $3.40, which is also still above our average cost. We cannot justify and we have told the Canadians if they expect any response by Natural Gas Pipeline to this plan, it must be modified.

Senator PERCY. I understand in the several discussions you have had with your Canadian counterparts you have talked about the take-or-pay obligation and how it could be modified in light of current market conditions. What is the status of these particular discussions? Have you agreed on anything yet?

Mr. LAWRENCE. Senator, we have not. To explain to you why since February to now what is going on, I need to describe a little bit the relationships. Let me do so this way:

Natural Gas Pipeline purchases gas from Great Lakes, Great Lakes Pipeline. It is a United States facility which transports only Canadian gas. They purchase their gas from TransCanada Pipeline. TransCanada Pipeline purchases its gas from a variety of producers in Canada. So what we are talking about is a series of steps. Our relationships are with Great Lakes. Their relationships are with TransCanada. TransCanada's relationships are with its producers.

Now I don't mean to put Great Lakes aside, but with Great Lakes we look through to TransCanada, and we are working with TransCanada and they in turn are working with their producers. This is one of the problems we have and why elsewise it has been viewed as inordinate delay. We don't have the ability to deal directly with the producers. It is our contract with Great Lakes, their contract with TransCanada, then the contract between TransCanada and the producers. But the problems occur all the way back into the producers. Or saying it another way, whatever is a problem with the producer contract comes forward to the ultimate contract under which we purchase gas. So that is the situation.

Now, you asked specifically about take or pay. As I have indicated in my statement, our statement to you, we have chosen to approach this on the basis of price. It will be of little advantage if we seek some relief for this year on take or pay only to find out that nothing happens on the price side and the problem reoccurs next year. So what we are looking for is some combination that does not cause a confrontation which, No. 1, provides prices that are appropriate to our marketplace, not a uniform border price and not at some other point, to our consumers. No. 2, given that, then we can deal with take or pay, we can deal with the take or pay that we are incurring. That is, we will have some by the end of this year, you are correct, and we can deal with that. But the key thing is to insure it doesn't just occur again and we have to answer your question next year "What are you doing this year?" We consider the take-or-pay issue to be a stopgap issue, particularly so if we can deal with the matter of price.

Where we are with the Canadians, we were there. We made a proposal to them. It is contained in the testimony in concept, and I would like to keep it in concept. We talked with TransCanada. TransCanada asked us to talk to their producers to describe the situation here in the United States, what we would do with the incentive plan. We did

so and made a proposal to them that the plan just announced be modified for further price reductions. TransCanada then separately went in and met with its producers after they heard from us, and I am not privy to that. That was between the producers and TransCanada. We have talked with TransCanada about proceeding forward.

I would also add there are a number of customers involved between Great Lakes and TransCanada. The needs of Natural Gas Pipeline may not be the same needs as the other U.S. customers of Great Lakes and, therefore, TransCanada. What we basically want is price relief, take-or-pay relief, and some means of dealing with the problem.

Senator PERCY. I would like to get a little better understanding of some of the specifics of the deal that you have made. How, for instance, would the interest payment that you owe the Canadians be computed?

Mr. LAWRENCE. At this time Natural Gas Pipeline does not have an arrangement that deals with interest payments. I believe what you are speaking to is something that has been in the press, most recently this week in the Wall Street Journal, relating to how TransCanada and Great Lakes dealt with the issue of take or pay last year with some other customer. That arrangement did involve interest. To put it to you simply, that is something we know about. That is something that is a means of relief. But I would like to see what TransCanada could do with its producers to see whether there isn't some additional relief that may be available. But I believe it is required. It is not therefore easy to say what does interest mean? We don't have such an arrangement. That is what is left to do, we made the price proposal, and wait to get their response.

Senator PERCY. Going back again to try to translate what you have done in this deal and putting it in very practical, specific terms, what can I say this weekend back home as to what effect this deal will have on consumers in Illinois? How will they see the impact of this deal?

Mr. LAWRENCE. Senator, the deal isn't made, but I do want to be responsive to you. We have made a proposal how the prices ought to be adjusted. It was to the Alberta Petroleum Marketing Commission. Those people have been here and involved in some of the government discussions. And the comments we received were not negative. The proposal that we made was considered by them thoughtfully. They have taken it back. The comment was made, "we were waiting for a proposal."

Senator PERCY. Can we just put it the other way. If the proposal you have made doesn't go through and isn't consummated in a deal, what effect would that have on consumers?

Mr. LAWRENCE. At this point I would have to be in the hypothetical. Let me do it in simple arithmetic. If a U.S. buyer were to incur something in the order of $100 million in take or pay due on imported gas, under the conventional way that that is handled the pipeline would make that payment. It would then become a matter to be included in its rates at sometime in the future. That would be a part of activity before the Federal Energy Regulatory Commission. Assume it went into the rates. The effect would be about $20 million would be added to the annual cost of gas of that pipeline company. And if that pipeline company were something like ours selling 900 billion to 1 trillion

cubic feet per year, it would mean on 1 trillion cubic feet, $20 million, that there would be about a 2-cent increase in the cost of the gas. That is the conventional way in which take or pay domestically is dealt with. That, by the way, using the numbers that I gave you, would constitute about less than 1 percent increase in the cost of gas delivered to the cities, and therefore less than that to the end user, residential people.

Senator PERCY. You have really had discussions going back over a period of time, and as long ago as a month ago you indicated you anticipated agreement being reached shortly. What has transpired and happened that has delayed this? I take into account we don't reach agreements overnight on such things as El Salvador and the Mideast, but this isn't as complicated as some of those problems. What is holding up progress?

Mr. LAWRENCE. As I said, we have talked with TransCanada for some time about this and testimony indicates we have a number of meetings. The problem is that TransCanada must deal with its producers, and then whatever can be agreed to there, it is my understanding, would have to be then also formulated and approved at the provincial level and probably at the Federal level within Canada.

The stumbling block now, I use that word and I don't wish to point fingers, but it is at the stage between TransCanada and its producers, because the proposal, I believe, I suspect, that TransCanada has made to its producers was not accepted and so we are in the next stage. As you said, there are complicated negotiations. This one may be simpler than many. But, nonetheless, one cannot negotiate in public. And we are proceeding along.

What I would like to propose to you is I believe that this can be put together, the proposal by the private parties involved, in the next 5 or 6 weeks, and that what we ask to do to be responsive to your question, I understand there is a method whereby the record can be left open, or whatever the method, we be allowed to supplement to you and inform you on the status of this as we progress past the price modification offer that Natural has made, to receive the comments on that and to incorporate the other reliefs which the U.S. buyers are seeking, that we can tell you this is what the private parties involved have agreed to do, subject to governmental and regulatory approval, if that would be sufficient.[1]

Senator PERCY. Again, just to be sure I understand, it appears as though you are going to be able to wrap this up in 5 or 6 weeks. My deadline, obviously, and the deadline of our consumers, is to know if we are going to have some relief or not as we head into the winter heating season. I want to also know before the Senate takes up the natural gas bill in the fall. Could you provide me with this report, let's say, by the end of August? As we come back from the Labor Day recess, I would like to have that report and a few days before so the staff could study it.

Mr. LAWRENCE. Senator, we would be glad to give you a report on that day. And I would add this, if there is one piece missing yet, the moment that piece falls in line we will supplement our end of August report to tell you what deal it is we have struck, subject to approval.

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[1] The information referred to was not received prior to printing.

Senator PERCY. Thank you very much indeed.

You did suggest one other aspect of this problem. It is an unusual situation and you have commented on the difficult and unusual nature of it. The Government of Canada unilaterally sets the prices which customers in the United States must pay. You and I both agree the Canadian problem is far from being solved. What, in summary, do you feel we in the Congress should do now to stimulate further progress on this issue?

Mr. LAWRENCE. Your concerns have been very effective so far. By that I mean the letter that you sent to us telling us of this hearing before it was even officially known what day, that language of that letter I received, and I called Canadian suppliers and informed them and read your letter to them over the phone. They have been supplied with correspondence that deals with the concerns of the Congress, and it is effectively helping us deal with the matter. It is one of the reasons I believe I can make the statement there is some expectation we can bring this to conclusion at least between the parties involved in the next 5 or 6 weeks. I don't know that I would ask for more help because we have stated our position. We are the buyers and sellers negotiating. We need to do the negotiating because we best understand the problems, and there are problems of understanding, I might add. The Canadians do not necessarily understand how things work on this side of the border in detail, and I must admit we don't fully understand how it works up there. One of the best results of the meeting yesterday with TransCanada, with the Petroleum Marketing Commission, with Pro Gas, with the producers, was a little better dialog to get a better feel of what is happening and the understanding if we can't work this out, it may be, in fact, you will have to work it out for us. We would like a chance to complete the party-to-party negotiations, and then when you see our response you may decide whether more is required.

Senator PERCY. Very good.

May I ask if we have a representative of the Canadian Government in the audience today in the hearing? Could I see your hand if we do? [One person raised his hand.]

Thank you very much. I am delighted that you are here. I would have been disappointed if you had not been. If you had not been, I would have called the Ambassador to give him a full report on the hearing. But it helps for you to be here firsthand. We have wanted, as good friends, to transmit our strong feelings on this matter.

And with you, Mr. Lawrence, I couldn't agree more than we must move toward a situation in which United States pipelines are freer to deal directly with Canadian pipelines and producers, unencumbered by a uniform border price set unilaterally by the Canadian Government, as a free, market-oriented country would recognize in the end that a free market operates most effectively in the long run for both consumers and producers.

I want to thank you again for your testimony. It has helped us shed a great deal of light on a very complex problem involving our current import situation.

Mr. LAWRENCE. Thank you.

[The prepared statement of Mr. Lawrence follows:]

24-411 O - 83 - 2

PREPARED STATEMENT OF LOUIS A. LAWRENCE

Mr. Chairman and Members of the Subcommittee:

My name is Louis A. Lawrence, and I am Assistant Vice President of Planning for Natural Gas Pipeline Company of America (Natural), reporting directly to George L. Morrow, the President of Natural. I am and have been involved in negotiations regarding Natural's Canadian purchases. The purpose of appearing before you today is to discuss Natural's efforts to reduce the border price and to bring about resolution of the take-or-pay problem.

BACKGROUND

Natural is one of the largest interstate gas transmission companies in the Nation and has historically sold approximately five percent (5%) of all gas sold in the U. S. Natural's pipeline network consists of 12,500 miles of pipeline comprising two (2) major transmission systems. One extends from the west Texas and New Mexico natural gas producing areas, the other from the Gulf Coast area of Texas and Louisiana. Both systems terminate in the Chicago metropolitan area. The company is a partner in three (3) major off-shore gas transmission systems in the Gulf of Mexico which connect off-shore production to Natural's pipeline system. Natural is

also a partner in a new pipeline system that was completed last fall. This is the Trailblazer Pipeline, which links the markets of the Midwest and the East with gas reserves in the Rockies. As can be seen, Natural has access to gas from every major domestic producing area.

The company also owns and operates an extensive system of underground storage facilities to provide storage services to its customers and to balance supply availability with market demand. The underground storage facilities owned and operated by Natural represent approximately eleven percent (11%) of the total interstate gas storage capacity in the U. S.

Natural currently supplies approximately two-thirds (2/3) of the gas consumed in the state of Illinois, the fifth largest gas consuming state. It also supplies about one-fourth (1/4) of the gas consumed in Indiana and one-third (1/3) of the gas consumed in Iowa. In the past, Natural received appproximately five to six percent (5-6%) of its total supplies from Canada. Natural does not receive any gas from Mexico or any liquified natural gas (LNG) from overseas.

Natural received its first delivery of Canadian gas from Great Lakes Transmission Company on November 1, 1970, under a contract providing for up to 155,000 Mcf per day. As a

result of several amendments offered by Great Lakes, that contract currently provides for up to approximately 170,000 Mcf per day. Great Lakes receives all of its gas from TransCanada PipeLines, Ltd. Authorization to purchase up to 75,000 Mcf per day from ProGas, Ltd. was received in 1979. In order to better balance supply and demand, such volumes were initially assigned to other U. S. purchasers. Natural began receiving the ProGas volumes on November 1, 1982.

In light of current market conditions and the cost of Canadian supplies, we are only taking 25,000 Mcf per day out of a total contract availability of 245,000 Mcf per day. While both contracts permit Natural to reduce takes to zero, both have take-or-pay provisions that generally require payment for any gas not taken below seventy-five percent (75%) of the full contract volume. The contracts do, however, provide for later make-up of gas not previously taken. Data sheets concerning each of these contracts are attached to this testimony.

Over the years, Canada has proven to be a reliable source of supply. In particular, during the shortages of the mid-1970's, Canadian volumes greatly aided Natural in providing continuity of service to its customers. Also, the Great Lakes volumes are beneficial from an operational standpoint because they are delivered to Natural near the Wisconsin-Illinois border, a factor that is included in the overall design and

operation of Natural's system. Such volumes can significantly aid Natural in its efforts to meet peak demand in its primary market area.

CURRENT ISSUES.

The issues relating to Canadian imports are:

1. Prices in excess of market clearing levels.

2. Take-or-pay liabilities accruing under contract terms as purchases are reduced to avoid high cost supplies.

3. Future need for Canadian supplies to augment domestic supplies.

Any solution which addresses only one of these issues without considering the others will be incomplete.

Throughout this year, Natural has had numerous telephone conversations and meetings with its Canadian suppliers. We met with both ProGas and TransCanada in late June. We met again with TransCanada in Chicago on July 12 and 13, and we are scheduled to meet with TransCanada and its

producers in Calgary tomorrow, July 28th. In these talks, we have strongly expressed the economic and political realities associated with high priced Canadian gas at this time, and have stated Chairman Percy's concerns regarding payment for gas not taken.

1. Price. The key concern now and in the future is pricing. The natural gas industry in the U. S. is going through a period of transition. The primary issue is whether readily available supplies can be marketed in the face of competitively priced alternative fuels. Because of this convergence of average gas costs and the costs of alternative fuels, it is absolutely essential that all gas sources, both domestic and foreign, be market sensitive as to price.

Natural's average cost of gas is among the lowest in the industry. Yet it is acutely aware of the need for action today that will ensure continuing competitiveness with alternative fuels. To this end, Natural has advocated that the price of natural gas must be responsive to changing market conditions and competitive with alternative energy sources. This is in recognition of the fact that, as with any commodity, prices for natural gas must be competitive with alternative supplies. No fixed price, arbitrarily established by a government, can be a substitute for a pricing arrangement negotiated by a buyer and a seller.

For this reason, we have developed a net-back pricing concept that we believe will be more responsive to changing market conditions. This concept is based upon a market clearing price that is designed to allow natural gas to compete effectively in all market sectors. Under this concept, the price of alternative fuels in each market sector is determined and, with consideration given to the cost of transporting and distributing natural gas to these markets, a weighted-average wellhead price is determined.

Natural believes that the present system of governmentally imposed uniform border prices will not provide the necessary vehicle for obtaining the required market sensitive gas pricing. Although we are encouraged by the recent actions of the Canadian government in lowering the base price of gas to $4.40 and in establishing an incentive price of $3.40 for certain volumes, and while such reductions are a step in the right direction, they do not go far enough in providing the necessary price relief. With a base border price of $4.40 (U.S.) per MMBtu and an incentive border price of $3.40 per MMBtu, either Canadian border price exceeds Natural's average cost of gas.[1/] With a base quantity of 50% of contract

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1/ On July 22, 1983, Natural filed a Purchase Gas Adjustment (PGA) with the Federal Energy Regulatory Commission (F.E.R.C.) to be effective September 1, 1983. Subject to F.E.R.C. modification, that PGA indicated an average cost of gas purchased during the period starting September 1, 1983 of $2.54 per Mcf.

required to be purchased by Natural at $4.40 per MMBtu to qualify for the incentive price, the average cost of Canadian gas at most can be reduced to $3.90 per MMBtu if full contract volumes were to be purchased. This average cost of $3.90 per MMBtu exceeds the average cost of comparable volumes available from domestic sources. When transportation costs are added to this average price of $3.90 per MMBtu, the cost of Canadian gas equals the cost of No. 6 residual fuel oil in Natural's market, without allowing for additional distribution costs.

In short, the Canadian pricing mechanism still results in governmentally imposed prices that are not responsive to the demands of the marketplace. Therefore, Natural has intensified its discussions with its Canadian suppliers in an effort to reduce further the cost of Canadian supplies.

While Natural recognizes that the Canadian government establishes border prices under present policy, we have discussed with our Canadian suppliers the market clearing pricing theory described above. They are aware of the need to move toward such a pricing format in order to enhance Natural's ability to market gas and to maximize the development of Canada's natural gas resources.

Natural has proposed a modification of Canada's recently announced Volume Related Incentive Pricing program which would significantly reduce the average cost of our Canadian supplies. This proposal would reduce the base volume to be purchased to qualify for the incentive price and reduce the incentive price, all to achieve an average cost comparable to domestic sources. If mutually satisfactory modifications result from those discussions, such modifications would need to be submitted for necessary governmental review and authorization.

2. Take-or-Pay. Natural's Canadian contracts provide for take-or-pay payments, and as indicated above we are currently incurring exposure under such contract provisions as a result of lessened takes. Stop-gap measures directed only toward currently accrued take-or-pay obligations will not prevent the problem from reoccuring and in fact may only delay the problem. What is necessary is a further price modification or a permanent reduction in existing take-or-pay levels. By far the better course is a further price reduction because both U.S. and Canadian interests would be well served.

3. Future Need for Canadian Reserves. Notwithstanding the current problems of excess deliverability, the natural gas industry still needs new long-term reserves to

meet future market requirements. For its part, Natural has been and continues working with all suppliers, both domestic and Canadian, to deal with this dilemma of short-term excess deliverability created by high prices and decreased demand, and the continuing need for long-term additional reserves.

Last year some five percent (5%) of our needs were met with Canadian imports, while this year we currently project that Canadian imports will provide only about three percent (3%) of our supply. This is the result of the higher costs of our Canadian supplies in relation to other sources available to us. In the future, however, Canadian imports could satisfy a greater percentage of Natural's annual supply requirements, assuming, of course, increased demand and workable pricing levels. This is by way of background for the view that while Canadian prices are currently higher than most available domestic supplies, we recognize that Canada has been as secure and reliable a source of gas as have been Natural's other sources, and that it continues to offer an attractive alternative for the future to augment domestic supplies.

Domestic supplies are currently surplus to a reduced level of demand for natural gas. As the economy returns to a normal growth pattern, demand for natural gas should increase. This, coupled with the depletion of current domestic reserves,

may result in a need for additional Canadian supplies in the future. We therefore recognize the need to maintain Canadian supply sources to satisfy future requirements. In recognition of (a) this potential future requirement, (b) the present dedication of Canadian facilities to serve U.S. markets, and (c) the Canadian domestic economic condition, we realize that some compromise may be appropriate in dealing with the current imbalance between the Canadian border price and U.S. market conditions.

CONCLUSION.

We believe that our course of action properly addresses the key issues of price, take-or-pay and future need for Canadian supplies as they impact our customers. Further modifications to the Canadian pricing program will serve the related objectives of lowering gas costs, reducing or eliminating take-or-pay costs, maintaining access to developed resources, and utilizing the considerable investment in existing facilities in both the United States and Canada. We solicit your support in our efforts to modify Canada's Volume Related Incentive Pricing program. We further solicit your support in reaching a government to government agreement which will permit direct negotiation between buyers and sellers on all contract terms, including price, subject to appropriate public interest review by each government.

I would be pleased to respond to any questions you might have.

GREAT LAKES

GL-20 & GL-37

Service Agreement Term: Nov. 1, 1970 through Oct. 31, 1980

Present Contract Quantity: 171,325 Mcf/d

Delivery and Cost:

Route	Cost
Great Lakes-Emerson, Manitoba to Crystal Falls, Mich.	$ .30
Michigan-Wisconsin-Crystal Falls, Mich. to NGPL at South Woodstock & South Joliet	$ .08
Total	$ .38
Border Price	$4.40
Delivered Cost	$4.78

Take or Pay:

Volume: 75% of Annual Contract Quantity

Price: Alberta Border Price plus TransCanada transportation charges. Estimate for 1983: $2.68/Mcf

Makeup: Any deliveries in excess of 46.9 Bcf/year.

PROGAS

GL-56

ProGas: A consortium of Alberta producers

Dates:

Negotiations Started	Mid-1978
Contract Executed	May, 1979
Initial deliveries to NGPL:	Nov. 1982
NEB approval of ProGas amendment:	Jan. 1983

Contract Term: Nov. 1, 1980 to Oct. 31, 1989

Contract Quantity (MMcf/d)

81-82	82-83	83-84	84-85	85-86	86-87	87-88	88-89
37.5	75	75	75	60	45	30	15

Delivery and Cost:

Northern Border, Moncy, Sask. to Ventura, Iowa	$ .43
Northern Natural, Ventura to Glenwood, Iowa	.04
Total	$ .47
Border Price	$4.40
Total	$4.87

Take or Pay:

Volume: Daily contract vol. x days x 0.75 x FERC factor*

Price: Border price*

Makeup: Any deliveries in excess of annual volume in any year. Any prepayments for gas not recovered will be reimbursed.

* FERC factor was established by FERC to limit open ended nature of take or pay dollar exposure due to changes in the border price. It is calculated as a ratio of the price existing at the time of authorization (escalated) to the current border price.

Senator PERCY. We welcome back Rayburn Hanzlik, Administrator of the Economic Regulatory Administration, Department of Energy, and Ms. Paula Daigneault, Director of the Natural Gas Division.

Before introducing our next witness, I would like to mention that this subcommittee had originally extended an invitation to Mike Butler, Chairman of the Federal Energy Regulatory Commission, to testify at this hearing. After the subcommittee had extended its invitation, the Commission issued a show cause order in the Trunkline case. At issue in this show cause order are serious questions regarding Trunkline's compliance with its contractual obligations. In light of this new action by the Commission, Chairman Butler indicated that he felt it would be inappropriate for him to testify before a congressional committee. In my view, it would have been simple and straightforward to arrange that neither Mr. Butler's prepared statement, nor questioning of him by members of the subcommittee, would have prejudiced the FERC inquiry. But I firmly believe that the American people are entitled to absolute fairness in legal proceedings, and we take extraordinary caution in that regard, including the proceedings of the FERC. We must take every step necessary to assure that Mr. Butler, as one of the decisionmakers, has total confidence in his ability to participate fairly in the *Trunkline* case. For this reason, I granted his request not to testify and be present for questioning, and instead requested that he submit a written statement for the record.[1] I would like to insert for the record the letter I received from Chairman Butler and my reply to him regarding the hearing. Without objection—there is no one here to object—it will be made a part of the record here at this point.

[The letters referred to follow:]

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[1] See p. 84.

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D. C. 20426

OFFICE OF THE CHAIRMAN

July 22, 1983

Honorable Charles H. Percy
Chairman
Subcommittee on Energy,
Nuclear Proliferation and
Government Processes
Committee on Governmental Affairs
United States Senate
Washington, D. C. 20510

Dear Chairman Percy:

By letter dated June 23, 1983, you invited me to testify at the "second oversight hearing on government management of natural gas import issues" to be held before the Subcommittee on Energy, Nuclear Proliferation and Government Processes of the Senate Committee on Governmental Affairs. The subject of the hearing is to be "the Federal Energy Regulatory Commission's efforts to deal with the effects of gas imports on U. S. consumers." As you are aware, I earlier testified at the first such oversight hearing held on February 28, 1983. See Government Management of Natural Gas Import Issues: Hearing Before the Subcomm. on Energy, Nuclear Proliferation, and Government Processes of the Senate Comm. on Governmental Affairs, 98th Cong., 1st Sess. 94 et seq. (1983). After reviewing the transcript of that hearing, I have concluded that it would be inappropriate either for me or any member or employee of the Commission to appear. The Commission has a duty to protect the decisional process from Congressional intervention that may undermine its integrity. See American Public Gas Ass'n v. FPC, 567 F.2d 1016, 1069 (D.C. Cir. 1977). I must, therefore, respectfully decline your invitation.

When I last appeared to testify on these matters, your chief counsel was advised that the Trunkline LNG project was the subject of a show cause order concerning Trunkline LNG's authorization to import and resell Algerian LNG. See "Order to Show Cause, Consolidating Proceedings, and Prescribing Expedited Procedures," Trunkline LNG Co., et al., Docket Nos. CP74-138-000, et al. (issued September 24, 1982). In that proceeding, a recommended decision had

been provided the Commission by its Chief Administrative Law Judge on January 28, 1983. It was the subject of sharp criticism at the hearing (Tr. 99-100, 112-15). Additionally, I was subjected to interrogation about my opinion of that decision (Tr. 100) and to strongly worded views about how the Commission should rule in the matter (Tr. 100-101). Furthermore, there was a probing of the mental process of me qua decisionmaker in violation of the teachings of U.S. v. Morgan, 313 U.S. 409, 422 (1941) (Tr. 101). All of this occurred despite the fact that the adjudication was ongoing. The Commission's decision in that matter was issued the evening of the hearing, Commissioner Sousa's and my separate statement were issued several days later, and the order on rehearing was issued several months later.

Based on these facts, there is no doubt in my mind that the first oversight hearing constituted an unconstitutional intrusion into the due process rights of the parties to the Trunkline adjudication. My conclusion is drawn from the striking similarity of the facts in Pillsbury Co. v. FTC, 354 F.2d 952, 954-962 (1966), to the procedural posture of the Trunkline LNG case before the Commission on February 28 and the nature of the interrogation by both Senator Levin and you. In Pillsbury, Judge Tuttle, writing for a three judge panel, found the following:

> We think it is not necessary to consider the contention of petitioner here that the House hearings, conducted a little earlier, were also damaging to Pillsbury and were of such a nature as to deprive it of procedural due process. We conclude that the proceedings just outlined constituted an improper intrusion into the adjudicatory processes of the Commission and were of such a damaging character as to have required at least some of the members in addition to the chairman to disqualify themselves.
>
> . . . .
>
> [C]ommon justice to a litigant requires that we invalidate the order entered by a quasi judicial tribunal that was importuned by members of the United States Senate, however innocent they intended their conduct to be, to arrive at the ultimate conclusion which they did reach.

354 F.2d at 963. Furthermore,

> . . . when such an investigation focuses directly and substantially upon the mental decisional processes of a Commission in a case which is pending before it, Congress is no longer intervening in the agency's legislative function, but rather, in its judicial function. At this latter point, we become concerned with the right of private litigants to a fair trial and, equally important, with their right to the appearance of impartiality, which cannot be maintained unless those who exercise the judicial function are free from powerful external influences.
>
> . . . .
>
> To subject an administrator to a searching examination as to how and why he reached his decision in a case still pending before him, and to criticize him for reaching the "wrong" decision, as the Senate subcommittee did in this case, sacrifices the appearance of impartiality--the sine qua non of American judicial justice--in favor of some short-run notions regarding the Congressional intent underlying an amendment to a statute, unfettered administration of which was committed by Congress to the Federal Trade Commission.

354 F.2d at 964 (footnote omitted). Every secondary source of which I am aware cites the Pillsbury doctrine with approval. The only difference between what happened in Pillsbury and what happened in the February 28 hearing was that, notwithstanding legislative pressure to the contrary, the FERC issued a decision inconsistent with opinions expressed at the hearing.

We have just issued a follow-up show cause order in connection with the Trunkline LNG proceeding. See "Order to Show Cause," Trunkline LNG Co., et al., Docket Nos. CP74-138-010, et al. (issued July 18, 1983). As indicated in both the majority order and separate concurrence in the earlier proceeding, there remains a question whether Trunkline LNG is in compliance with its certificate. If the facts show it is not, the Commission could be paralyzed from taking remedial action as a result of the prejudicial impact of further appearances before Congress in connection with the matter. Obviously, the prejudice extends not only to Trunkline LNG and other parties to the proceeding, but also to your constituency as the consequence of the Commission's resulting inability to grant them relief.

In conclusion, I must say that these matters were reviewed by the Commission's General Counsel and with your chief counsel before the last hearing. Additionally, there were express references to the Pillsbury problem at that hearing (Tr. 115-16). I would respectfully suggest that in the event you choose to pursue this matter further, you seek an independent judgment on both the wisdom and propriety of the hearings, perhaps from Counsel to the Senate or the White House Counsel.

If you have further questions in this connection, or if I can be of other service, please advise.

Yours very truly,

C. M. Butler III
Chairman

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WILLIAM A. CUDDY
CHIEF COUNSEL AND STAFF DIRECTOR

United States Senate
COMMITTEE ON
GOVERNMENTAL AFFAIRS
SUBCOMMITTEE ON ENERGY, NUCLEAR
PROLIFERATION AND GOVERNMENT PROCESSES
WASHINGTON, D.C. 20510

July 27, 1983

Mr. Charles M. Butler, III
Chairman
Federal Energy Regulatory Commission
Department of Energy
Washington, D.C. 20426

Dear Mr. Butler:

As a United States Senator, I have been concerned about the potential impact of unwarranted increases in the price of natural gas on my constituents, the people of Illinois. As Chairman of the Subcommittee on Energy, Nuclear Proliferation and Government Processes, I have been concerned about important issues bearing on how the agencies of the U.S. government charged to carry out natural gas import policy have discharged their responsibilities. I regard the Subcommittee's investigations and and hearings in this area as a fully appropriate exercise of the legislative and oversight responsibilities vested in the Congress under Article I of the United States Constitution.

As a representative of the people of Illinois, I have also taken every appropriate opportunity to press my concerns before the agencies involved. In the fall of 1982, a pending price increase for Algerian LNG was challenged in a proceeding before the Federal Energy Regulatory Commission (FERC). I felt then that the best way to represent Illinois' interests was to intervene and testify publicly before the Administrative Law Judge assigned to the case. Accordingly, I petitioned to intervene and subsequently testified. Although I was not pleased with the Judge's decision in the Trunkline case and criticized it publicly, I am satisfied that my views were considered together with those of the other parties to the case.

Subsequently, on Febraury 28, the Subcommittee on Energy, Nuclear Proliferation and Government Processes held a hearing on government management of natural gas import issues at which you testified. You now suggest in a letter dated July 22 that your appearance at the hearing constituted "an unconstitutional intrusion into the due process rights of the parties to the Trunkline adjudication." In support of this conclusion, you cite that FERC had not reached a final decision in the Trunkline case, and that the Subcommittee was therefore interfering in a pending proceeding.

This suggestion is troubling in that it is totally contradicted by the official statements issued by the FERC prior to the hearing.

As you know, the FERC announced in an official press release dated February 23 that it had decided to dismiss the protests against the Trunkline-Panhandle project. (See enclosure.) The release stated that "[t]ne decision brings to a conclusion a proceeding that began last fall when a group of utilities, industrial customers, state agencies and members of Congress from Michigan, Missouri, Illinois, Indiana, and Ohio protested LNG imports." The three-page release described the Commission's decision in substantial detail. Further, the prepared statement you submitted to the Subcommittee the day before the hearing, and the oral testimony you gave at the hearing, referred to the Commission's "recent decision" in the case, clearly indicating that it had already been made. Under the circumstances, all those concerned with the case, myself and Subcommittee staff included, had every reason to believe the FERC had reached its final decision on the matter. Thus, when the Subcommittee received your testimony on February 28, it was with the understanding that the rights of the parties had been fully decided by the Commission, that the case was concluded, and that it was therefore entirely appropriate for the Subcommittee to question you about it in the course of a broader inquiry into government management of natural gas imports.

Finally, the fact that you have not removed yourself from the Trunkline case, even after the Commission's recent decision to issue a show-cause order, is the strongest possible suggestion that you believe your role as decisionmaker was not jeopardized by the Subcommittee's February 28 hearing and that you still feel qualified to sit on this case. I conclude that we have carefully observed the due process rights of the parties in the case, and that nothing in the February 28 hearing has interfered with them.

At this hearing, you said that because the Trunkline decision was still subject to rehearing, you could not discuss its merits. In my view, the Congress would make a mockery of its constitutional responsibilities if it delayed the consideration of legislative solutions to public problems until, after years of litigation, the courts have ruled on compliance by federal officials with existing constitutional and statutory requirements. When new legislation may solve these problems, the Congress should not refrain from informing itself at hearings of the nature and urgency of the problems. The Congress must have the information and opinions of knowledgeable officials, in order to make informed legislative choices. This is our duty.

Furthermore, the right of the Congress to inquire into a public problem which is also the subject of litigation is firmly recognized by the Supreme Court. The Subcommittee does not seek to compel disclosures for the purpose of affecting the prosecution of suits, and, as the court said in the case of Sinclair v. United States, "the authority of [Congress], directly or through its committees, to require pertinent disclosures in aid of its own constitutional power is not abridged because the information sought to be elicited may also be of use in such suits." In Hutcheson v. United States, the court observed that "a congressional committee which is engaged in a legitimate legislative investigation need not grind to a halt whenever response to this inquiries might potentially be harmful to a witness on some distinct proceedings..."

Our purpose for the February 28 hearing was to shed light on important management issues this Subcommittee is charged to oversee. As you know, three different federal agencies -- FERC, the Economic Regulatory Administration and the Department of State -- have statutory roles that affect execution of U.S. natural gas import policies. You noted in your statment to the Subcommittee that these roles are sometimes confusing and may be in need of clarification or change. Recent developments affecting the price and supply of such imports form virtually all foreign sources raise important questions about implementation of policy that go far beyond the questions involved in the Commission's decision in the Trunkline case. It is my intention to review these broad issues further at the hearing scheduled for July 29.

I invited you to testify on July 29 so that the Subcommittee might have the benefit of your testimony on a full range of issues involving government management of natural gas imports. Your staff raised none of the problems discussed in the July 22 letter and, indeed, led the Subcommittee staff to believe that the only reason you might not be available to testify on that date was that you had a scheduling conflict due to an earlier commitment you had made to be in San Francisco. However, I am advised by your July 22 letter that since you received my invitation to testify at the forthcoming hearing, the Commission has reopened the Trunkline case and has issued a show-cause order. In your letter, you state your belief that "the Commission could be paralyzed from taking remedial action as a result of the prejudicial impact of further appearances before Congress in connection with the matter." I disagree. It would be simple and straightforward to arrange that neither your prepared testimony, nor questioning of you by Members of the Subcommittee, would touch on the issues involved in that case, while receiving your testimony on the issues that are part of our inquiry.

This problem of imported natural gas is a serious one. High gas prices continue to cause tremendous financial hardship to businesses and consumers in Illinois. For this reason, I shall chair a hearing on this issue on July 29, as planned. But I also believe that you, as a decisionmaker, should have total confidence in your ability to participate fairly in administrative decisions of the FERC.

Accordingly, I have decided to grant your request not to testify at the July 29 hearing, and instead request that you submit a written statement for the record presenting your views as to the FERC's role in natural gas import policy in light of current market conditions and future import certificates. On some future occasion, as appropriate, I may ask you to testify and submit to Subcommittee questioning.

Sincerely,

Charles H. Percy
United States Senator

CHP:arj

Senator PERCY. We are pleased to have Ray Hanzlik, the Administrator of the Economic Regulatory Administration, before the subcommittee. Mr. Hanzlik, in addition to his regulatory responsibilities, is the administration's lead official on gas import policy issues. Since we last had him before the subcommittee in February, he has engaged in direct talks with both the Canadian and Algerian Governments. Last week, he announced that ERA would hold a public conference in September to consider new criteria for natural gas import certificates.

Mr. Hanzlik, the subcommittee welcomes your status report on what the Government's role has been on natural gas imports over the last several months, and what you see lying ahead.

As we have discussed among us, I don't try to cover the waterfront. We don't take up every issue that Congress deals with. I limit the areas I work on and I try to do a thorough job. And we do intend, as I told you originally, to stay right with this. It is not just a hearing for the record; it is a hearing to see results and get results. And I very much appreciate the followthrough you have been making, and we will stay right with it until we find an answer to this problem.

TESTIMONY OF RAYBURN D. HANZLIK, ADMINISTRATOR, ECONOMIC REGULATORY ADMINISTRATION, DEPARTMENT OF ENERGY, ACCOMPANIED BY PAULA DAIGNEAULT, DIRECTOR, NATURAL GAS DIVISION

Mr. HANZLIK. Thank you, Mr. Chairman. I would like to express my personal appreciation to you for having these hearings. These hearings provide us a very special opportunity to discuss and develop our views and get the value and knowledge you have to impart to us. I think we have been finding that your interest in this area has proved very helpful in a number of areas which I will allude to.

I do have a prepared statement which I would like to read, primarily because I have made some changes to it, as you probably have done en route to giving a speech. If you bear with me, it takes about 10 minutes, but I think it contains significant developments we are announcing and I would like to read it.

Senator PERCY. I have gone over it. My copy does not have pencil marks. I am sure everyone in the room would like to hear that statement.

Mr. HANZLIK. Thank you.

Mr. Chairman, I do appreciate the opportunity to review with this subcommittee the administration's activities relating to natural gas imports since my appearance last February. We have been very active during this period to facilitate market reliance as the method by which natural gas is imported into this country. I will focus my statement on this work.

We, in the administration, share with you and your colleagues in the Congress the acute awareness of the economic hardship being experienced today by consumers and businesses from distorted natural gas prices. While we may not have the degree of direct contact that you have with individual citizens, we nonetheless feel plenty of the same

heat. This consumer concern has served to reinforce our commitment to reform the governmental regulatory system that has brought about this economic condition, with the President proposing early this year legislation to reform the existing natural gas laws. The Congress is now considering reform legislation, with the Senate Energy and Natural Resources Committee having reported out a bill last Tuesday that contains many of the elements of the President's proposal. It is our hope that Congress will pass legislation that will bring about an ordered gas market, with prices set by market forces and not by the Government.

Imported natural gas, like domestic gas, has been regulated by the Government. As in the democratic gas market, the effect is that there are gas import contracts with pricing provisions that are inconsistent with the current demands of the market. Our position on imported gas is that import arrangements should be based on contracts freely negotiated between the foreign seller and the American buyer. The Government's role in these transactions, we believe, should be to assure that all gas imports are priced by the market process. Many gas import arrangements do not have enough flexability, with the result that they are not fully adjusting to today's gas markets. To resolve the current marketing problems of imported gas, we must reestablish fundamental market principles in our international gas trade. We need to do this expeditiously, and steps are now underway to bring this about.

Earlier this week, I issued a notice for public comments as the final part of our review of the criteria that have previously been employed in authorizing natural gas imports. To insure full public participation in this review process, a conference will be held on September 8. Representatives of the Department of Energy, Federal Energy Regulatory Commission, and Department of State will be present to hear the views and suggestions of interested parties on the implementation of our market-based import policy.

Our new policy is needed to provide the environment necessary for buyers and sellers to negotiate market-oriented, flexible natural gas import arrangements that will assure long-term supply availability from supplemental reliable sources. The new criteria we intend to put in place to review gas import proposals will reflect this policy position and move the Government away from regulating the terms and conditions of gas contracts. The September conference and written comments we receive will assist us in establishing the basis for authorizing gas imports. We expect to announce this by early October.

The results of the policy-development process will be an important element in establishing our long-term gas trade relationships with Canada, Mexico, Algeria and other countries from which we may import gas in the future. In effect, we will be enunciating the principles upon which the gas import trade with the United States is to be based. Our trading partners will have to recognize that gas imported into the United States has to flow under arrangements that make it competitive in our markets.

My discussions with Government officials in Canada and Algeria in recent months have emphasized this position. We have told these officials that our gas market is undergoing change in the direction of

a free market and they must be prepared to compete in this new environment. Canadian gas suppliers with whom I have had discussions particularly welcome this opportunity to compete without the artificial constraints of Government pricing regulation. All parties acknowledge that a fully competitive gas market does not exist today in this country and that it will not exist until changes are made in our current gas laws. However, the stage is being set for the implementation of our new import policy.

The extensive bilateral discussions that we have had in the past months have served to establish the proper atmosphere for establishing new trade principles. In meetings with our Canadian counterparts, we have already identified the problems that need to be solved, most notably price and volume terms, before we can both enjoy a stable future gas trade relationship. I can assure you that the Canadians are as interested as we are in progressing toward a stable natural gas trade relationship. The United States is a key market for the substantial surplus natural gas produced in Canada, and the Canadian Government is fully mindful that concerns in this country over its export price, which have prompted hearings like this one today, may jeopardize these needed U.S. markets.

The Canadians are willing to compete in an ordered United States market, such as would result from passage of legislation consistent with the principles included in the President's regulatory reform proposal. Since February, discussions between the Governments have been taking place, including the reactivation of the United States-Canada Energy Consultative Mechanism, better known as the ECM. In April, Canadian Energy Minister Jean Chretien met in Washington with Secretary Hodel on this subject, as did Alberta Premier Peter Lougheed in May. Members of Congress, especially you, Senator Percy, have also expressed views on this subject to Canadian officials. I have met on numerous occasions with senior Canadian Federal and provincial officials in Canada and in Washington to discuss the problems of high Canadian gas prices in our markets and to explore steps to help solve these problems by lowering the price, which is uniform at the border.

As evidence of the force of market conditions, the Canadian Government has taken a series of actions designed to respond to present market demands. On April 11, an 11-percent reduction was announced for the uniform border price, with the $4.94 million Btu price dropped to $4.40. This reduction is expected to save the U.S. consumer about $380 million per year, based on 1982 import volumes. Consistent with its practice of following Canadian price adjustments, the Mexican Government also lowered its gas export price to $4.40.

Other signs of Canadian flexibility followed this price reduction. On May 12, the Canadian National Energy Board approved a waiver permitting a Canadian gas exporter, PanAlberta Gas, Ltd., to negotiate with Northwest Alaskan Pipeline Co. a short-term downward revision of the volumes of gas obligated to be taken. This action eases minimum annual bill obligations for United States customers and offers promise of Canadian Government sanction of buyer-seller negotiations.

Then, 3 weeks ago, on July 6, Energy Minister Chretien announced a second pricing revision in which gas above certain base volumes would be priced at $3.40 per million Btu. This discount program, termed volume-related incentive pricing, better known as VRIP, has had an immediate impact on some U.S. markets and should have broader impact during the coming heating season. Pacific Gas Transmission Co. in California expects to save its customers about $112 million during the next 12 months. We estimate that five other U.S. importers will have approximately $13 million by November 1.

The Canadians are clearly committed to remaining competitive in our natural gas market. In announcing the incentive pricing program on July 6, Minister Chretien stated, and I quote:

Canada values the United States as a long-term market for natural gas surplus to Canadian needs. For this reason, we are willing to do our part to insure that natural gas remains a competitive fuel within the U.S.

The recent Canadian pricing reductions may not be a total response to the demands of the United States markets, but they represent significant adjustments and evidence of flexibility during this period of transition to a competitive domestic gas market. Canadian gas at $4.40 is now priced below some unregulated United States produced gas, and the discount price of $3.40 approximates the price of gas charged to Canadian consumers.

I know this subcommittee is particularly interested in our efforts relating to the importation of Algerian liquefied natural gas [LNG], with specific interest in the proceeding involving Trunkline LNG Co. This proceeding, which was partially decided last February, is pending before me and I cannot, therefore, discuss the merits of the case. In fairness to the companies involved and other interested persons, I intend to render a decision as promptly as possible. Barring unexpected procedural complications, I expect to issue the final Trunkline decision before the beginning of the coming heating season.

Mr. Chairman, I believe Secretary Hodel also reaffirmed that commitment to you at your hearing last month.

In late April, I headed a United States delegation to Algiers, where we had discussions with Algerian Government energy officials. These discussions, which included Minister of Energy Nabi, focused on the problems in the current United States gas markets and the economies of Algerian LNG in these markets. These discussions were useful in exchanging important information relating to United States-Algeria gas trade.

I should add, Mr. Chairman, Minister Nabi sent a delegation of Algerian energy ministers to Washington this week, and I spent the day yesterday continuing these discussions. I believe they are meeting with you this afternoon.

In all of these discussions, while we gain an appreciation of the viewpoints and considerations important to the exporting country, we represent the interests of the American citizens.

Senator PERCY. I think we ought to emphasize that again. That is the role that you have. And in a sense, though, in all my business experience, I have never found when we do represent our own interests we also in a sense represent the interests of those with whom we

are doing business, because if we don't properly represent our interest, that relationship can't continue. And I have had to close off relationships that just didn't work out because they weren't walking in the shoes of the interest we have to serve. But we have to walk in their interest to keep a steady supply and be a good customer. But I would like to emphasize that sentence you gave in your testimony there. It is absolutely right.

Mr. HANZLIK. I appreciate your comment, and that sentence was put there for precisely that reason. I will read it again.

In all of these discussions, while we gain an appreciation of the viewpoints and considerations important to the exporting country, we represent the interests of the American citizens. These interests are best and squarely served by ensuring that two important concerns are kept foremost: That this country maintain a fully adequate supply of natural gas; and that this gas be available in the quantities and at the price that the market determines. The United States requires imported gas to supplement its own production, and it is likely that this will be true in the future. As we work with our gas trading partners to craft import arrangements appropriate to our market conditions, it is important that we properly balance these concerns.

We are aware that there are proposals in the Congress that would impose restrictions and conditions on the gas import arrangements with our trading partners. We would like to discourage this type of legislative action, as it could prove counterproductive to the long-term interests of this country. We are now implementing a market-oriented gas import policy to insure that import arrangements are responsive to the demands of the market. This policy, combined with the passage of gas regulatory reform legislation leading to an ordered natural gas market, is the "fix" that our current problems need. With our attention to these efforts, the economic hardship now experienced by many consumers can be removed.

This concludes my prepared statement, Mr. Chairman. I would be pleased to answer your questions.

Senator PERCY. Thank you very much indeed. And I would only add one element to this. This is an area where we are working, some of us, intimately with the President, as you are working with the President, to put natural gas prices and all energy costs in the context of our battle—which we are leading, and we are hoping other countries are following—against inflation. Inflation just really undercuts the value of savings. It undercuts the value of wages. We have had real wages go down steadily for a decade and a half now as a result of ruinous inflation. As I campaign through Illinois with the President time after time, I can see him say we promise you we are doing to do something about inflation: And I can see the cynicism and skepticism, written in people's faces, "We have heard that before from you politicians." Here was one public official that was different. He stuck with this in every single meeting I have been in with him. This inflation problem, getting interest rates down, and getting this economy rolling has been a fixation with him. And what we have seen is an absolutely dramatic reduction in inflation, from 18 percent down to 0.9 percent on an annual basis for the first 3 months of this year. And the social security checks will be about 3.5 percent in January. That will be the lowest

increase, but it means their money really means more, their savings mean more, their income means more, their social security will buy more than ever before in the last several decades.

So I do think we should do everything we can to continue to battle energy costs, those and hospital costs, those are things we really must be focusing attention on. Hospital costs we are going to be working on this year late in the year and next year. But energy costs, we simply must do as much as we possibly can about now.

I think your statement has been extraordinarily helpful and it touches on a number of important policy issues that are of great importance to the Congress and for us to keep in mind in our future consideration of natural gas legislation.

Natural Gas Pipeline Co. testified this morning, as you have heard, that we must move toward a general import policy in which companies are able to negotiate directly with one another over gas prices, rather than leaving it to foreign governments to set gas prices. From your statement, I take it you agree with this goal?

Mr. HANZLIK. Absolutely.

Senator PERCY. If this is our goal, what further steps must we take vis-a-vis foreign countries exporting to the United States to get to this point?

Mr. HANZLIK. Senator, as I indicated in my statement, we are in the process now of finalizing a market-oriented import pricing policy, and our plan is between now and October at the latest, we will have a series of activities, including this conference. Following this, we plan to announce the criteria we will henceforth employ in natural gas import prices. We are not going to consider any arrangement that doesn't have the market flexibility or a market mechanism built into it; otherwise it will not be authorized. We think this is a major policy advance. It is consistent with the President's natural gas regulatory reform proposal. We want to keep in parallel with that; and I think, as far as we are concerned, we have the responsibility for the authorizations of import arrangements. They are all going to be subjected ultimately to this new policy criteria.

Senator PERCY. You mentioned in your statment the upcoming conference that ERA plans to have in September on gas imports. I welcome that conference. But I would have to also add I have the same cynicism that the Illinois audiences have when politicians address them. We had a similar hearing last winter, and since that hearing we have really seen no real change in U.S. gas import policy. Are you planning to have this conference really make a difference and not just be another bull session?

Mr. HANZLIK. I can appreciate that observation. Certainly that would be the appearance, I think, to some. But it is not quite the way the system has been working. The January conference was designed to hear initially from our importing pipelines, consumers, public utility commissions of the States what they would like to see changes in our import arrangements, and we heard loud and clear then that they would like a more free market-oriented system. Representatives of foreign governments were at that conference and could hear, I think, for the first time in a public forum these viewpoints and these concerns. That began our process of reviewing how we implement the

needed changes. Simultaneously, of course, we were discussing with various government officials in Canada and Algeria to prepare them for and discuss with them what was happening. This conference in September is a culmination of this process. We are discussing very specifically what the criteria should be that should dictate or determine an import arrangement.

One of our concerns, Senator, is that it is one thing to have a flexible policy or flexible contract that is market responsive, but these contracts also are used to finance large capital projects. The banks and financial institutions obviously need some sense of stability in these large contracts in order to lend the capital necessary. So one of the questions we are raising in our conference is, as we move into this market-flexible arrangement policy, what do we need to take into account to protect the investment in future projects? It is questions like this we are going to address in September. As I have already indicated, in several weeks after the conference, we will conclude our assessment and come forward with our policy criteria announcement. Then the criteria will go into effect immediately.

Senator PERCY. I don't have any doubt that we agree on our long-term goals. The question for me is, what kind of relief will consumers receive while all the discussions and conferences are going on? Natural mentioned its efforts to deal with their take-or-pay obligation. Could you describe what other pipelines are doing in this area? Specifically, I would be interested in what other pipelines serving Illinois and neighboring States are doing because we do have the possibility of severe weather and high prices.

Mr. HANZLIK. Mr. Chairman, there are a number of adjustments being negotiated and I would like Ms. Daigneault to give you some specific examples in a moment. One of the senior officials of a pipeline company came into my office earlier this week and he said, "You know, it is interesting, changes are taking place between the parties almost in spite of the Government's activities." We see a broad range of these changes and adjustments being negotiated also, in spite of the governments, which I think is an encouraging sign that the free market and market conditions are already forcing the necessary changes. I think what we want to do is get Government out of the way and not impose the kinds of onerous regulatory restrictions which have made this so difficult in the past. There are, I guess, 6, 8, or 10 companies that have already renegotiated aspects of their arrangements with Canada, and if you will bear with us, Ms. Daigneault can give you a couple examples of that.

Ms. DAIGNEAULT. Senator, Mich Wisc., which I also believe serves Illinois, has worked out an agreement with TransCanada to pay only the interest on its $75 million debt for gas undertaken during the contract year ending October 1982, and to forego the principal until the mideighties. Of course, Panhandle Eastern is one of the shippers on the ANGTS—Alaskan Natural Gas Transportation System—and the shippers are working out an arrangement with PanAlberta to reduce their takes. In fact, the takes have actually been reduced.

Northern Natural has halved its purchases via the eastern leg to 90,000 million cubic feet a day from 190,000 million cubic feet a day. Panhandle reduced the gas purchases via the eastern leg by 50 percent,

from 150 million cubic feet a day to 75,000, and United cut back purchases to 150,000 million cubic feet per day, one-third of the contract volumes and less than a half, 325,000 million cubic feet a day, the contract's take-or-pay levels that it had been buying.

Given these reductions which had taken place, the four pipelines reached a tentative agreement with PanAlberta through Northwest Alaskan, which is the actual importer, to amend their basic sales contract to provide a 40-percent take requirement on an annual basis for 1983 and 1984, while providing PanAlberta with a stream of cash flow to meet its take-or-pay obligations to Alberta producers, including a financing scheme for take-or-pay payments whereby U.S. purchasers will arrange for funds to be made available as loans or as payments for gas not taken by PanAlberta on an interest-free basis during 1983 and 1984.

The NEB gave a waiver to permit these negotiations to continue onwards, saying, in principle, they would approve such an agreement. As I understand it now, the American companies are trying to arrange for financing.

Senator PERCY. Thank you, Ms. Daigneault, very much.

I would like to go back to the position Natural Gas has taken. They stated the Canadian incentive price has no effect on them. In your statement, Mr. Hanzlik, you noted 90 percent of the benefit from this incentive pricing by the Canadians would go to one California pipeline. What do you think about Natural's suggestion that the Canadians modify the volume-related incentive program they recently announced?

Mr. HANZLIK. The incentive pricing program is going to benefit some pipelines in certain regions more than others. We have informally polled, if you will, all the pipelines that import Canadian gas to get an estimate from them as to which thinks it will benefit from the discount system. I believe there are seven or eight that indicated they will be able to take the incentive priced gas, and I would say 12 or 15 said they would not. So I would estimate maybe a third or more of the pipelines will benefit by this, particularly those serving the west coast, where a higher volume of Canadian gas has been flowing. But this is all premised, of course, on projections about the heating season and what the demands are going to be in the market and what kind of winter we are going to have. So if there is a heavy cold winter in which gas consumption rises, this would have more of an impact than if there is a winter like last winter.

Senator PERCY. I would now like to look for a little direction from you on whether you need further legislative assistance. Let's go back for 1 minute to our earlier discussion about the ERA's attempt to develop a new criteria for reviewing import licenses. Under the DOE Organization Act, Congress has granted DOE fairly broad authority in the import area. Do you foresee the need for any legislative changes in your authority in order to move toward a more market-oriented import policy which we all desire?

Mr. HANZLIK. I think section 3 of the Natural Gas Act which establishes the authority that the DOE Act has given to the Secretary of Energy, who, in turn, has delegated it to the Administrator of ERA, is sufficiently broad and specific to serve its purpose. I think the concern

we have, and I alluded to it in my statement, is any embellishments to that authority that might occur in the process of considering the current natural gas reform legislation.

As you are aware, the Senate Energy Committee has an amendment that it is considering or is proposing to offer on the floor, when the natural gas bill comes up after the recess, that would change section 3 of the Natural Gas Act to be much more specific and restrictive. I understand the reasons for this, but I would hope that the activities we are into right now and the results we have will satisfy the concern in the Congress that import policy is consistent with a market-oriented approach and that legislation is not required. I think that remains to be proven, but that is our position.

Senator PERCY. Finally, a question that I would like to put to you that I would like to share with the members of the Energy Committee, if they haven't already put the question to you, relating really to your role vis-a-vis the other agencies which made decisions affecting U.S. gas import policy. At our February hearing, Chairman Butler indicated that statutory changes were needed to clarify the responsibilities of the agencies involved in approving natural gas imports. He specifically referred to certain reviews which he found duplicative between the FERC and ERA that could ultimately lead to possible conflicting decisions. I would appreciate your views on this problem and his suggestions for legislative changes to solve it.

Mr. HANZLIK. There is a problem, Mr. Chairman. I discussed this problem several months ago with Secretary Hodel who suggested that—he tossed the ball back to me—I sit down with Chairman Butler and see if the two of us can work out recommendations to solve the problem. Import policy and regulation were all vested in the Federal Power Commission prior to the formation of the Department of Energy in 1977. When the DOE Act gave the function to the Secretary of Energy, he split it between the FERC and the ERA, in which the ERA has section 3 responsibility and the FERC has sections 4, 5, and 7. The problem has been that there is essentially an overlap of jurisdiction. The theory is that the DOE authorizes imports, licenses them, if you will, and then the FERC passes on ratemaking and facility certification. But in those inquiries there tends to be a duplication of the same issues and the same evidence. So we are now in the process of trying to take steps to make clear lines of authority between the two agencies in which the Department of Energy will have all policy-making responsibility and the FERC will have a more traditional role in its ratemaking and certification responsibilities. That decision, I think, will be worked out sometime in early September.

Senator PERCY. Well, I think clarification there would be important. I am delighted that you are working on that.

I just have one last comment. I would like to repeat something that I believe I said at our last meeting. And if I didn't say it, it should be said; and if I did say it, it bears repeating.

Spelling out a new U.S. import policy should be straightforward. I appreciate the fact that you are convening this conference—but just convening it is not enough. We really need results from it. The American people, in my judgment, should pay no more than fair market prices for any imported energy at any time under any circumstances.

I really hope the focus of that conference can be put on helping us achieve this policy. And if it does, it will be one of the most worthwhile conferences for the American consumers and for the relationship that can exist between ourselves as a customer and foreign governments and foreign producers that we could have. And I think the focus placed there would be vital. And we do very much appreciate the objective that you have set out and appreciate your testimony very much indeed.

Mr. HANZLIK. Thank you, Mr. Chairman.

Senator PERCY. Our final witness today will be Mr. E. Allan Wendt, Deputy Assistant Secretary for International Energy Policy, Bureau of Economic and Business Affairs, Department of State. Accompanying Mr. Wendt will be Prescott Wurlitzer, responsible for energy relations with Canada, and David Sloan, responsible for energy relations with Algeria and Mexico.

Mr. Wendt, and your colleagues, I welcome you before this subcommittee once again. A great deal has transpired since you last testified. I understand you have been to Algeria to discuss the LNG pricing problem. We have not had a chance to talk personally about your trip. As the administration's lead official in developing policy for the State Department on gas import matters, you have also been very closely involved with the United States-Canada Energy Consultative Mechanism. Your views this morning will be particularly helpful to the subcommittee's consideration of natural gas import problems, and we look forward to having your statement at this time and having you join in any way you see fit by your colleagues and their comments.

TESTIMONY OF E. ALLAN WENDT, DEPUTY ASSISTANT SECRETARY FOR INTERNATIONAL ENERGY POLICY, BUREAU OF ECONOMIC AND BUSINESS AFFAIRS, DEPARTMENT OF STATE, ACCOMPANIED BY PRESCOTT WURLITZER AND DAVID SLOAN

Mr. WENDT. Thank you very much. I have submitted a statement for the record and, with your permission, I will give now the highlights of that statement.

Senator PERCY. The full statement will be incorporated in the record.

Mr. WENDT. Thank you.

I appreciate very much the opportunity to appear again before this subcommittee to provide the State Department's views on gas import issues. I found the previous hearing at which I testified very useful. I think this kind of exchange is helpful to us. We hope it is also helpful to the Congress in dealing with this very important issue of gas imports.

I said in February that this issue was a very high priority to the State Department. I can reaffirm that again today. We are continuing our efforts along with other agencies, notably the Department of Energy, to find ways to bring down the current high prices for gas imports.

Since February, there have been a number of developments in our gas trade relationships with all three of the gas exporting countries

that supply the U.S. market. We believe that certain of these events have laid an important foundation for a more flexible, market-sensitive natural gas trade. At the same time, we would agree that more work needs to be done both through diplomatic consultation and commerical negotiation so that our gas import arrangements can meet the test of the marketplace.

This morning I will focus my remarks on our bilateral gas trade with Mexico and Canada, especially the latter. But being aware of the interest, the very high interest that you have in the question of Algerian LNG, I would like to make a few observations about imports of Algerian LNG.

You mentioned the trip that I made to Algeria last May. I was with Ray Hanzlik on that trip. We thought it was extremely useful. We had a very frank and, I think, constructive exchange with Algeria's Minister of Energy and a number of high officials of their Ministry of Energy and of the state oil company, Sonatrach. Yesterday, officials from both the Departments of Energy and State had a second round of discussions with a high-level Algerian delegation, including officials of the Government of Algeria and Sonatrach. As in our previous discussions with the Algerians, we stressed our concern and the strong concern of the American public about the high price of Algerian LNG in the U.S. gas market. We emphasized again, as we did in May in Algiers, that contract flexibility is essential to meet these concerns and to preserve our gas trade, especially in a transition period in which we expect to be moving toward a deregulated domestic gas market.

I should say, Mr. Chairman, for their part, the Algerians cited the huge investments they have made to service the U.S. gas market and the compromises they believe they have already made in negotiations with U.S. companies.

Just as was the case 5 months ago, Mr. Chairman, the real question is whether long-haul Algerian LNG can be competitive in the United States energy market. It is a difficult question and, as you know, it is being addresed by the regulatory agencies right now. We will have further results from those deliberations, as Mr. Hanzlik said, in the very near future.

Let me just mention briefly events concerning imports of Mexican pipeline gas. While Mexico provides a relatively small amount of imported gas compared to what Canada supplies, Mexico has been a reliable supplier to the consortium of pipeline companies in the Border Gas Group. Following Canada's lead, Mexico recently cut its border price for exports to the United States to $4.40 per million Btu, and gas shipments have been reduced to take-or-pay minimums of 180 million cubic feet per day. We think these changes reflect both Canada's and Mexico's awareness of the changing U.S. gas market. Further adjustments may be necessary, and we are prepared, if circumstances warrant, to enhance our normal dialog with Mexico on the full range of our bilateral energy relationship.

Now, a great deal has been said already this morning, Mr. Chairman, on recent developments with Canada and I think there is no point in my going over that ground. We know from your own statement and from earlier testimony what the recent developments are. We think

we have made definite progress with our largest source of gas imports in moving our relationships to a more flexible and market-sensitive basis. This has taken the form of both price and volume relief for the American consumer, and I think demonstrates that Canada has come a long way in becoming sensitive to the problems of our gas market here and trying to adapt to that market.

Mr. Chairman, in summary, I would like to make the point that the actions that have been taken recently demonstrate that further progress can be achieved through diplomatic and commercial channels toward our objective of moving our gas trade to a more market-sensitive basis. We do think, as do the other witnesses, that this is the soundest basis for our gas import trade, that is, one based on direct buyer-seller negotiations that reflect market demand, subject to regulatory approval. We believe that the progress achieved thus far demonstrates it is worth continuing these efforts in preference to legislative action, which we feel would be cumbersome and inflexible.

That is a summary of my prepared statement, Mr. Chairman, and I will be happy to try to answer any questions that you have.

Senator PERCY. Thank you very much, Mr. Wendt.

We heard earlier from Natural Gas Pipeline that the incentive price scheme recently announced by Canada would not benefit Natural or their customers. Is this the case with other pipelines, and particularly other pipelines in the Middle West? Who does get the benefit from that incentive price scheme?

Mr. WENDT. Mr. Chairman, as I believe Mr. Hanzlik said earlier, it is true the primary beneficiaries will be in California. But, according to my information, there are at least two pipeline companies in the Middle West that will benefit. We understand Intercity Minnesota Pipeline Co. will save $700,000 this year.

Senator PERCY. Which pipeline?

Mr. WENDT. Intercity Minnesota Pipeline Co. will save $700,000 this year. Perhaps not a huge amount, but not insignificant because of the volume-related incentive pricing situation. And Texas Eastern, which I understand also serves the Middle West, will save $6.6 million. The other four companies that will benefit operate outside the Middle West, mostly in California.

Senator PERCY. With only then a slight benefit to one Midwestern State. If the incentive price has such little effect on the pipelines serving the bulk of their gas to the Middle West, what hope do you see in the future for further relief from imported gas prices still well above the domestic acquisition price?

Mr. WENDT. Mr. Chairman, as was also revealed this morning, I think there is still hope for near-term relief for some companies and for American consumers in the Middle West through direct negotiations between those companies and their Canadian gas suppliers. In some instances, I believe volumetric relief has already been provided. Two of the four companies that will benefit from the Pre-Build settlement with the Canadian supplier, Pan Alberta, are Northern Natural and Panhandle, both of which serve the Middle West. According to our estimates, this relief package could reach $350 million over a 2-year period. And we expect other Midwestern companies, such as Natural Gas of Chicago, to receive similar relief packages from their

Canadian suppliers before the end of the contract year. We think that Canada's National Energy Board has been very helpful in supporting the relief packages sought by American companies with their Canadian suppliers. Perhaps, as Mr. Lawrence testified, still more can be done. But I think a certain degree of progress has been recorded in this area.

Senator PERCY. Could you provide us with a more detailed status report on the State Department's and DOE's bilateral consultative sessions with the Canadians on energy? I would be particularly interested in having more details. In particular, why was the recently scheduled consultative session canceled? What is intended for future sessions?

Mr. WENDT. Mr. Chairman, we had planned a meeting in June in Ottawa, our second full meeting of the bilateral energy consultative mechanism, but before the meeting could take place, we thought it might be more fruitful to postpone it because the Canadian Government had not yet announced the volume-related incentive pricing scheme, which we thought was an essential step in further progress toward a more market-oriented gas supply arrangement between the United States and Canada. The Canadians readily acquiesced in the postponement. I think they shared our view that it would be more productive to postpone the session until after the Canadian Government had been able to agree upon and announce the new VRIP, as it is called. I hate to use the acronym, but I think everyone knows what it is by now. So we postponed that meeting and we now plan to have another meeting of the bilateral energy consultative mechanism in September. No date has been fixed. We will be in touch with the Canadian Government to agree on a date. August doesn't seem to be a very propitious month for such a meeting with so many people away on vacation. At our meeting in September, we would hope to pursue discussions with Canada about establishing a longer term, market-oriented gas supply relationship and perhaps even to go into such issues as pricing principles for gas trade between the United States and Canada. We attach a great deal of importance to these discussions. We think we have come a long way since we first had those contacts, and we look forward to continuing them.

Senator PERCY. Very good.

As you know, this committee overall, the Governmental Affairs Committee, has the organizational responsibility with respect to the executive branch. We create departments. We try to eliminate overlapping and duplication. And I would like particularly to mention the fact that FERC Chairman Butler testified at our last hearing, which was last February, that the roles of FERC, DOE, and the State Department were at times confusing regarding natural gas import policy. Do you have any recommendations you can make to this committee on how the United States can develop a more coherent import policy which does not rely solely on prices unilaterally set by foreign governments and long drawnout regulatory proceedings?

Mr. WENDT. Mr. Chairman, I think this issue is basically a matter for the Department of Energy and I would want to defer to it in terms of such issues as overlapping jurisdictions between ERA and FERC. Mr. Hanzlik told us that DOE is seized with this problem right now and it is trying to resolve conflicting jurisdictions in a coherent, effective way.

Our interest in the Department of State is in preserving our role mandated by the DOE Reorganization Act of 1977, which gives to the Secretary of State the primary responsibility for the foreign policy aspects of international energy policy. So whatever is worked out within the Department of Energy, we would, of course, want to make sure that we are able to continue to play that role. Needless to say, it applies most particularly to natural gas imports. We have a very close and cooperative relationship with the Department of Energy, of which ERA is a part. That enables us to fulfill our legislatively mandated role. With the FERC, our relationship is necessarily more distant because it is an independent agency and any kind of communication we have with them would be on the public record. So it is not the same kind of confidential exchange that we would have with ERA.

Senator PERCY. Thank you.

I would like to ask, because I want to talk about Algeria, is there a representative of the Algerian Government in the room with us today? [One person raised his hand.]

Senator PERCY. There is. Thank you.

I will be meeting this afternoon with Mr. Ahmed Boutache, the First Secretary at the Algerian Embassy, and his colleagues to continue discussions about Algerian gas and our trading relationship.

Mr. Wendt, I would now like to go over a little history with you of our natural gas trading relationship with the Algerians. As you know, I have introduced legislation on this matter, and I think it would be useful to the Congress to get some of these facts on the public record.

In 1973, during the oil embargo, isn't it the case that deliveries of Algerian LNG to the United States, in this case, to Distrigas Co., were interrupted? And weren't these interruptions attributed to so-called technical difficulties? Could you give us as full a story or analysis of that as you can from the Department of State's standpoint?

Mr. WENDT. Mr. Chairman, I am not in a position to provide a lot of detail, but I believe your statement is correct. It is my understanding that Distrigas did not receive LNG supplies from Sonatrach for almost a 2-year period beginning in 1973.

Senator PERCY. That did come at a time that we were under oil embargoes, so we were very, very hard-pressed. Our economy was being injured severely by the oil embargo. We were closing schools; we were closing factories. Unemployment was rising. We had a lot of pressure on it.

In 1975 and 1976, at a time when the Algerians were trying to renegotiate prices upward, weren't supplies again interrupted, again because of so-called technical difficulties?

Mr. WENDT. Mr. Chairman, I am not aware of any prolonged delays or interruptions during this period, although I believe that deliveries to Distrigas during this period were not as regular as they have been in the recent past.

I would like to note also, Mr. Chairman, with respect to the earlier question, it is also true that in 1973, we were in the midst of the Arab oil embargo, but it didn't last the full 2-year period during which there were interruptions.

Senator PERCY. Isn't it true that, as in the case with Distrigas, deliveries from Sonatrach to Gas de France in 1980 were also reduced

to almost nothing, again due to so-called technical difficulties, at a time when the Algerians were trying to push prices higher?

Mr. WENDT. I believe that is correct, Senator.

Senator PERCY. I want to quote from a World Gas Report. That is a publication. In their publication dated April 14, 1980, they stated, and I quote directly:

> According to Gas de France, only a quarter of the usual Algerian LNG supplies were delivered last month. Sonatrach of Algeria has justified the reduction by pointing to technical difficulties experienced at Arzew and Skikda . . . The cutback has been interpreted by some observers as a possible negotiation maneuver . . .

This is the judgment at least of the publication World Gas Report. Is this correct?

Mr. WENDT. Mr. Chairman, I am not in a position to state precisely what the reasons were. We do know that there were interruptions. You have cited some of them. These are a matter of public record. The reasons advanced by Sonatrach involved technical difficulties. We have not been able, with any certainty, to identify the precise cause of the delays, interruptions, or delivery shortfalls. We simply noted that technical problems were cited as preventing Sonatrach from meeting its commitments.

Senator PERCY. I understand the Italians faced similar problems in 1982—more price discussions and more Algerian technical difficulties.

According to a report, and I quote now from the Wall Street Journal, September 28, 1982, I quote directly from that article:

> Italy and Algeria initiated a pricing agreement on natural gas shipments through the Trans-Mediterranean pipeline, ending a deadlock that had delayed the opening of the pipeline by nearly 1 year . . . During the price negotiations, Algeria, in effect, froze all commercial contracts with Italy in an effort to increase its leverage at the bargaining table.

Is this true?

Mr. WENDT. Mr. Chairman, according to my information, the Trans-Mediterranean pipeline was originally scheduled to start sending gas to Italy in October 1981. We understand that again technical difficulties were cited as an explanation for the delay, and gas was not actually piped through that line until earlier this month.

Senator PERCY. Just to indicate my own attempt to be consistent, the ill-fated, disastrous pipeline embargo that we engaged in for a while, we quickly realized our mistake and reversed. But, I contended, not from the start but 4 months ahead of the start, while it was just being contemplated, those policies are really self-defeating, and we have been mistaken ourselves on occasion.

Let me ask you about the El Paso situation, which I consider to be especially troubling. In 1979, I understand that, upon Sonatrach's request, El Paso entered into negotiations with Sonatrach over a new price in their contract. An amendment was executed between the two companies, but then subsequently El Paso was informed by Sonatrach of what the Algerians considered to be mistakes in the contract. The key mistake, as I understand it, was that the price was not high enough. In March 1980, El Paso received a telex from Sonatrach indicating that the Algerians considered the El Paso contract null and void. Deliveries of LNG ceased later that month. Finally, in 1981, El Paso withdrew from the project at a loss.

Secretary Wendt, is this generally a correct summary of what happened?

Mr. WENDT. Mr. Chairman, I believe that there is some question as to whether Algeria stopped deliveries or El Paso refused to take delivery of the LNG supplies. This is a complicated, drawn out affair with which I am not personally acquainted and I am ill-equipped to give details. I can say that when this issue comes up, one gets different answers from different people. But what is a fact beyond dispute is El Paso did not import Algerian LNG after 1980 and its LNG import operations have ceased entirely.

Senator PERCY. I have cited this because I am having a private meeting this afternoon with Algerian representatives, but I want to put right on the public record I want to discuss this with our Algerian friends at that meeting. We have a not too pleasant pattern that has developed. All of these incidents seem to demonstrate to me, the conclusion I come to, that Algeria has been willing to do what is necessary to push prices way up when the market has been tight. Now that the market is soft, the United States should do what is necessary to bring them back down to realistic market prices. But, instead, we have a U.S. pipeline coming back with an agreement which benefits the Algerians but certainly does not benefit the American customer. I can't get any benefit from that agreement that has been brought back. It just doesn't make any sense to me. As a businessman, I would be outraged if my CEO brought back to me a deal like that. That is a pretty one-sided deal. That is not a deal in favor of our customers. If we do not serve our customers, we are not going to be in business. And we are going to find a way to correct the situation. It has gotten me angry, and I usually don't get emotional around here, but it has gotten me angry. And I have expressed myelf as patiently and thoughtfully as I could for 2 years to three governments and the U.S. Government and the patience is running out. The time for action is now, not just talk and talk and talk. We are going to have some action. We are beginning to see some action and I think it is following through in some areas. It must follow through in others.

Mr. Wendt, are you aware of any existing natural gas import contract in which the import price is tied directly to OPEC oil prices?

Mr. WENDT. I believe, Mr. Chairman, that the Border Gas import contract with Mexico ties gas price changes to price movements in a basket of crude oils that includes several OPEC crudes. My adviser, Mr. Sloan, informs me the Mexican escalator clause is a proportional as opposed to an absolute one. In other words, if on a million Btu basis oil prices went from $5 to $5.50, that doesn't mean that if Mexican gas was at $4 it would also go up 50 cents. Instead, under the Mexican formula, the base price would go up 10 percent.

Senator PERCY. As a matter of general foreign policy, do you believe import prices should be tied in any fashion directly to OPEC oil prices?

Mr. WENDT. I think not, Mr. Chairman. I think a more suitable basis would be to tie gas import price changes to price movements in fuels that imported gas competes with directly, specifically domestic gas and No. 2 and No. 6 fuel oils.

That being said, Mr. Chairman, one could imagine circumstances in which it would work to the consumer's advantage if contracts were

tied to a basket of crude. But I think in general, as a binding principle, it makes more sense to tie them to competing fuel oils.

Senator PERCY. Absolutely. I certainly agree with you it would not be good policy.

In conclusion, you mentioned in your statement that you met this week with the Algerians. I hope you have conveyed congressional concerns to them. As I have said, I will be meeting with them this afternoon and I intend to convey to them my concern with these past trade problems we have gone over this morning, and then I am going to express my disappointment with this most recent agreement. And I hope we can conclude and reach agreement on a much more satisfactory basis that will have some real material effect in improving our long-term relationship with them and improving the immediate situation and adjusting ourselves to market conditions that are apparent to all of us. We can't live in a dream world. We live in a realistic world. We have market conditions that can't be overlooked, certainly not for too long without having a disastrous consequence.

[Mr. Wendt's prepared statement follows:]

PREPARED STATEMENT OF E. ALLAN WENDT

SINCE THE HEARINGS ON NATURAL GAS IMPORTS BEFORE THIS SUBCOMMITTEE ON FEBRUARY 28 OF THIS YEAR, THERE HAVE BEEN A NUMBER OF DEVELOPMENTS IN GAS IMPORT CONTRACTS WITH ALL THREE FOREIGN SUPPLIERS TO OUR MARKET. THESE DEVELOPMENTS HAVE MOVED US CLOSER TO A MARKET-RELATED TRADE IN GAS IMPORTS, ALTHOUGH CLEARLY MORE REMAINS TO BE DONE TOWARD THIS END.

-- MOST SIGNIFICANTLY, OUR LARGEST SOURCE OF IMPORTED GAS, CANADA, HAS AGREED TO REDUCE ITS BORDER PRICE BY OVER 10%, AND HAS ALSO PUT IN PLACE A VOLUME-RELATED INCENTIVE PRICING FRAMEWORK;

-- MEXICO, OUR OTHER SOURCE OF PIPELINE IMPORTS, HAS SIMILARLY REDUCED THE BORDER PRICE FOR ITS GAS EXPORTS TO THE U.S. MARKET, AND GAS SHIPMENTS HAVE BEEN CUT TO THE TAKE-OR-PAY MINIMUM OF 180 MILLION CUBIC FEET A DAY, REPRESENTING 60% OF FULL CONTRACT VOLUMES;

-- FINALLY, TRUNKLINE AND SONATRACH RECENTLY NEGOTIATED A CONTRACT AMENDMENT THAT, IF APPROVED BY U.S. REGULATORY AUTHORITIES, WOULD POSTPONE 40% OF TAKE-OR-PAY REQUIREMENTS AND WOULD ALSO SANCTION A NEW CONTRACT PRICE ESCALATOR THAT WOULD TEND, AT LEAST TEMPORARILY, TO REDUCE THE BASE PRICE FOR ALGERIAN LIQUEFIED NATURAL GAS (LNG).

I TESTIFIED IN FEBRUARY THAT NO ENERGY ISSUE HAS A HIGHER PRIORITY AT THE DEPARTMENT OF STATE THAN GAS IMPORTS. THIS REMAINS THE CASE. WE BELIEVE THAT EVENTS SINCE FEBRUARY HAVE LAID IMPORTANT GROUNDWORK FOR A MORE FLEXIBLE AND MARKET-SENSITIVE NATURAL GAS TRADE. BUT WE

ALSO RECOGNIZE THAT MORE WORK IS NEEDED, BOTH THROUGH DIPLOMATIC CONSULTATIONS AND COMMERCIAL NEGOTIATIONS, BEFORE OUR GAS IMPORT CONTRACTS FULLY REFLECT THE REALITIES OF TODAY'S GAS MARKET. FOR THE MOST PART, EXISTING PRICES AND CONTRACT VOLUMES FOR OUR GAS IMPORTS ARE NOT MEETING THE MARKET TEST.

WE ARE CONTINUING OUR EFFORTS, BOTH DIRECTLY AND THROUGH OUR ADVISORY ROLE WITH THE DEPARTMENT OF ENERGY (DOE), TO RESOLVE OUR GAS IMPORT PROBLEMS. THROUGH THE U.S.-CANADIAN CONSULTATIVE MECHANISM, WHICH THE STATE DEPARTMENT CHAIRS, WE WILL CONTINUE TO PURSUE WITH CANADA CHANGES IN OUR GAS TRADE THAT BOTH PROTECT U.S. GAS CONSUMERS AND SUPPORT OUR LONG-TERM GAS TRADE RELATIONSHIP. IN THE CASE OF ALGERIAN LNG, DOE AND STATE YESTERDAY HELD A SECOND ROUND OF HIGH-LEVEL DISCUSSIONS WITH OFFICIALS OF THE GOVERNMENT OF ALGERIA IN WHICH WE EMPHASIZED THE PROBLEMS FACING THE U.S. GAS MARKET AND THE NEED FOR CONTRACT FLEXIBILITY. TOGETHER WITH RAYBURN HANZLIK OF DOE'S ECONOMIC REGULATORY ADMINISTRATION, I VISITED ALGIERS IN MID-MAY WITH THE SAME MESSAGE, NAMELY THAT THERE ARE STRONG PUBLIC CONCERNS IN THE U.S. ABOUT THE HIGH PRICE OF ALGERIAN LNG AND THAT CONTRACT FLEXIBILITY IS ESSENTIAL TO MEETING THESE CONCERNS AND TO PRESERVING OUR GAS TRADE WITH ALGERIA TO THE BENEFIT OF BOTH COUNTRIES.

BECAUSE THERE IS PENDING REGULATORY ACTION ON THE CONTRACT CHANGES NEGOTIATED BY TRUNKLINE AND SONATRACH, MY REMARKS THIS MORNING WILL FOCUS ON EVENTS SINCE FEBRUARY IN OUR BILATERAL GAS TRADE WITH MEXICO AND CANADA, ESPECIALLY

THE LATTER. WITHOUT PREJUDICING THE STATE DEPARTMENT'S INVOLVEMENT IN THESE REGULATORY PROCEEDINGS AND WITHOUT PREJUDGING THEIR OUTCOME, LET ME BEGIN WITH A FEW WORDS ABOUT IMPORTS OF ALGERIAN LNG.

ALGERIAN LNG

WE ALL RECOGNIZE THAT IMPORTS OF ALGERIAN LNG ARE INHERENTLY MORE EXPENSIVE THAN PIPELINE IMPORTS. GAS FROM ALGERIA'S FIELDS MUST BE LIQUEFIED, TRANSPORTED A SUBSTANTIAL DISTANCE, AND REGASIFIED BEFORE IT CAN ENTER THE U.S. GAS SYSTEM. AS WAS THE CASE FIVE MONTHS AGO AT THIS SUBCOMMITTEE'S LAST HEARING ON GAS IMPORT ISSUES, THE QUESTION REMAINS WHETHER ALGERIAN LNG IS TOO EXPENSIVE FOR THE BASE-LOAD U.S. MARKET, BOTH IN THE SHORT-TERM AND LONGER RUN. THIS DIFFICULT QUESTION HAS BEEN ADDRESSED MOST RECENTLY IN A SHOW-CAUSE ORDER ISSUED BY THE FEDERAL ENERGY REGULATORY COMMISSION CONCERNING TRUNKLINE'S IMPORT PRICE.

AS A MATTER OF PUBLIC RECORD, I WOULD ALSO NOTE THAT THE FOB PRICE FOR BOTH CONTRACTS FOR ALGERIAN LNG IMPORTS INTO THE U.S. MARKET HAS BEEN REDUCED SINCE FEBRUARY. ON JULY 1, THE FOB PRICE FOR BOTH THE TRUNKLINE AND DISTRIGAS CONTRACTS DROPPED TO $3.51 PER MILLION BTU AGAINST A PRE-JULY 1 PRICE OF $3.87/MMBTU. THIS PRICE REDUCTION WAS A RESULT OF THE SEMI-ANNUAL PRICE ESCALATOR IN EACH CONTRACT THAT TIES PRICE CHANGES TO MOVEMENTS IN PETROLEUM PRODUCT PRICES.

MEXICAN GAS

I HAVE ALREADY NOTED THAT MEXICO REDUCED ITS PRICE

FOR GAS EXPORTS TO THE U.S. MARKET BY OVER 10% SINCE THE SUBCOMMITTEE LAST HELD HEARINGS ON GAS IMPORTS. VOLUME IS ALSO DOWN TO THE 60% "TAKE-OR-PAY" MINIMUM.

WHILE OUR BILATERAL GAS TRADE WITH CANADA HAS BEEN THE MAJOR FOCUS OF THE ADMINISTRATION'S EFFORTS ON PIPELINE GAS IMPORTS, WE HAVE CONTINUED A DIALOGUE WITH MEXICO ON GAS IMPORT QUESTIONS. DISCUSSIONS ON GAS AND OTHER BILATERAL ENERGY ISSUES TOOK PLACE EARLIER THIS MONTH WHEN DOE RECEIVED A MEXICAN TEAM. WE WILL CONTINUE THESE REGULAR MEETINGS WITH MEXICAN OFFICIALS AND, IF NECESSARY, SCHEDULE SPECIAL DISCUSSIONS IF THE NEED ARISES.

CANADIAN GAS

I AM PLEASED TO SAY THAT SINCE THE FEBRUARY HEARING WE HAVE MADE PROGRESS ON MOVING OUR BILATERAL GAS TRADE RELATIONSHIP WITH CANADA TO A MORE MARKET-SENSITIVE BASIS. THIS PROGRESS HAS COME IN THE FORM OF BOTH PRICE AND VOLUME RELIEF FOR U.S. PIPELINE COMPANIES AND AMERICAN CONSUMERS, AND DEMONSTRATES THAT CANADA IS WILLING TO ADAPT TO THE CHANGING SITUATION IN AMERICAN GAS MARKETS.

ON PRICE, THE CANADIANS MADE THE INITIAL MOVE ON APRIL 11 BY REDUCING THEIR UNIFORM GAS EXPORT PRICE BY 11% FROM $4.94 TO $4.40/MMBTU. IN THIS CONTRACT YEAR ENDING IN OCTOBER, WE ESTIMATE THAT THIS PRICE REDUCTION WILL SAVE AMERICAN CONSUMERS BETWEEN $100-150 MILLION.

ON JULY 6, CANADA MADE ANOTHER MOVE TO GIVE PRICE

RELIEF BY IMPLEMENTING A VOLUME-RELATED INCENTIVE PRICE (VRIP) FOR GAS EXPORTS TO THE U.S. UNDER THIS SCHEME, GAS SOLD TO U.S. COMPANIES IN EXCESS OF 50% OF FULL CONTRACT VOLUMES WILL BE PRICED AT $3.40/MMBTU, A 23% DISCOUNT FROM CANADA'S NEW BASE PRICE OF $4.40/MMBTU. IN THIS CONTRACT YEAR, ABOUT ONE-THIRD OF THE COMPANIES IMPORTING GAS FROM CANADA WILL BE IN A POSITION TO TAKE ADVANTAGE OF THE VRIP, WHICH WILL SAVE AMERICAN CONSUMERS AN ESTIMATED $85 MILLION.

REGARDING VOLUME RELIEF, IN RECOGNITION OF THE TAKE-OR-PAY LIABILITY SITUATION MANY U.S. IMPORTERS WILL FACE WITH THEIR CANADIAN SUPPLIERS THIS CONTRACT YEAR, CANADA'S NATIONAL ENERGY BOARD (NEB) HAS STATED IT IS WILLING TO CONSIDER VOLUMETRIC RELIEF PROPOSALS WORKED OUT BETWEEN THE COMPANIES. ON MAY 11, THE NEB APPROVED A SETTLEMENT THAT THE PREBUILD GROUP OF THE ALASKA NATURAL GAS TRANSPORTATION SYSTEM (ANGTS) (UNITED, PANHANDLE, NORTHERN NATURAL AND SOCAL/PACIFIC INTERSTATE TRANSMISSION) NEGOTIATED WITH THEIR CANADIAN GAS SUPPLIER PAN ALBERTA. UNDER THE AGREEMENT, THE AMERICAN PIPELINE COMPANIES WILL HAVE THEIR TAKE-AND-PAY LEVEL OF 78% REDUCED TO 40% UNTIL NOVEMBER 1984. THE AMOUNT OF THE ENTIRE TEMPORARY RELIEF PACKAGE COULD REACH $360 MILLION OVER THE TWO YEAR PERIOD. WE EXPECT OTHER U.S. GAS IMPORTERS AND CANADIAN SUPPLIERS TO PRESENT SIMILAR VOLUMETRIC RELIEF PACKAGES TO THE NEB AND U.S. REGULATORY BODIES BEFORE THE END OF THIS YEAR.

WE ARE CONFIDENT THAT FURTHER PROGRESS CAN BE

ACHIEVED THROUGH DIPLOMATIC AND COMMERCIAL CHANNELS IN MOVING OUR GAS TRADE WITH CANADA TO A MARKET-SENSITIVE BASIS. WE BELIEVE THAT SUFFICIENT PROGRESS HAS BEEN MADE TO JUSTIFY CONTINUATION OF THESE EFFORTS IN PREFERENCE TO LEGISLATIVE ACTION THAT COULD BE CUMBERSOME AND INFLEXIBLE. SINCE WE BEGAN OUR DISCUSSIONS WITH CANADA, WE HAVE ARGUED THAT THE SOUNDEST BASIS FOR OUR BILATERAL GAS TRADE IS ONE BASED ON DIRECT BUYER-SELLER NEGOTIATIONS REFLECTING MARKET DEMAND, SUBJECT TO REGULATORY APPROVAL IN BOTH COUNTRIES. SINCE NEITHER OF OUR GOVERNMENTS IS ABLE TO PREDICT GAS PRICES IN THE FUTURE, WE BELIEVE IT IS ESSENTIAL THAT AMERICAN BUYERS AND CANADIAN SUPPLIERS HAVE THE FLEXIBILITY TO ADAPT TO CHANGING GAS MARKET SITUATIONS.

BECAUSE OF REGIONAL DIFFERENCES IN U.S. GAS MARKETS, WE SEE CANADIAN EXPORTS BASED ON BUYER-SELLER NEGOTIATIONS LEADING TO VARIED GAS PRICES AT THE U.S./CANADA BORDER. THIS PRICING FLEXIBILITY WOULD PUT U.S. BUYERS IN A MUCH BETTER POSITION TO NEGOTIATE LONG-TERM PURCHASE COMMITMENTS WITH CANADIAN SUPPLIERS. SUCH AN APPROACH, IN TURN, WOULD ENCOURAGE CANADIAN GAS PRODUCERS TO CONTINUE TO DEVELOP THE RESERVES AND INFRASTRUCTURE THAT HAVE MADE CANADA THE MOST IMPORTANT, RELIABLE, AND SECURE FOREIGN SUPPLIER OF GAS TO THE U.S. OVER THE DECADES.

I WOULD BE HAPPY TO EXPAND ON THESE REMARKS IF THE SUBCOMMITTEE MEMBERS HAVE ANY SPECIFIC QUESTIONS OR COMMENTS.

Senator PERCY. In closing, I want to thank all of our witnesses for being here today to help in the continuing fight to reduce the cost of overpriced imported LNG. It is my intent to continue fighting for the consumers of Illinois and other States, to bring rising utility rates under control. As we have discovered today, there have been improvements in this area over the past several months. Now we will need to push a little harder to curb these unreasonably high priced natural gas imports.

I will ask the record remain open for 30 days to incorporate any additional comments that may be submitted for the record.

If there is nothing further—there is no one here to bring up anything—the meeting is adjourned.

[Whereupon, at 11:55 a.m., the subcommittee recessed, to reconvene subject to call of the Chair.]

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

PANHANDLE EASTERN CORPORATION

July 22, 1983

William A. Strauss, Esq.
Chief Counsel and Staff Director
United States Senate
Committee on Governmental Affairs
Subcommittee on Energy, Nuclear
Proliferation and Government
Processes
Washington, D. C. 20510

Dear Mr. Strauss:

This letter will confirm and supplement our telephone conversation of July 19, 1983 concerning the hearings scheduled for July 29, 1983 before your Subcommittee.

Subsequent to July 1, 1983, the time my client accepted the invitation of Chairman Percy to appear at such hearing, the Federal Energy Regulatory Commission (FERC) on July 18, 1983 issued an order instituting a proceeding requiring Trunkline LNG Company and Trunkline Gas Company to show cause within fifteen days (by August 2, 1983) "as to (1) why (Trunkline LNG Company) should not be found to have violated its certificate, and (2) why (Trunkline LNG Company's) certificate should not be revoked." In view of this development and the other circumstances hereinafter discussed, we do not think it is appropriate for our witnesses to appear and testify at the scheduled hearing.

I called you to discuss the seriousness of our situation in the quasi-judicial proceedings we face before the FERC and, inevitably, the ERA. It is the Subcommittee's intention, I understand, to have not only my clients appear at the hearing, but also the Administrator of the Economic Regulatory Administration of the Department of Energy (ERA) and an FERC representative. It is also my understanding that one of the areas the Subcommittee wishes to explore is the details of the negotiations with Sonatrach. You confirmed the accuracy of these understandings.

As you will recall, I made a two-pronged request of you. I asked that the Subcommittee cancel its plans to have the Administrator and an FERC representative appear and that it postpone, or cancel, its request that our representative

appear. In support of these requests, I refer to the historical developments which give rise to our current posture before these agencies.

The Algerian LNG project has been the subject of considerable controversy and quasi-judicial proceedings before the FERC and the ERA for almost a year. The Subcommittee Chairman and other members of Congress have participated there as parties, generally in opposition to the position of my client. In addition, members of Congress and staff have had off-the-record contacts with one or both of the agencies involved. The results of the agency proceedings to a recent date have been set forth primarily in "DOE/ERA Opinion and Order No. 50" signed and issued by the Administrator of ERA on February 25, 1983; and "Decision and Order Dismissing Complaints," issued February 28, 1983, and "Order Requiring Special Reports" issued June 1, 1983, of the FERC. Both agencies reserved the possibility of further proceedings, dependent upon the results of price and/or volume negotiations to be conducted between Trunkline LNG Company and Sonatrach, the Algerian Government agency involved in our LNG project. Thus, we, your Subcommittee Chairman and other members of Congress, the Administrator and the FERC are enmeshed together in ongoing quasi-judicial proceedings which will determine the fate of my client's LNG project.

On July 3, 1983, Trunkline LNG Company reached an agreement with Sonatrach, culminating several months of negotiations predating and following the issuance of the agency orders of February 1983 above referenced. This information and the agreements were duly filed with the FERC on July 11, 1983, in accordance with its June order. The above referenced "Show Cause" order was issued by the FERC on July 18, 1983. Trunkline LNG Company will today or Monday file applications with both the ERA and FERC submitting the revised arrangement with Sonatrach for appropriate regulatory review.

My requests arise primarily out of concern for the integrity of any orders which may issue from the agencies in the quasi-judicial proceedings in light of the holdings or reasoning of courts in Pillsbury Company v. Federal Trade Commission (5th Cir. 1966), 354 F.2d 952, Koniag, Inc., Village of Uyak v. Andrus (U.S. App. D.C. 1978), 580 F.2d 601 and similar cases.

These proceedings must be conducted under long-standing Congressional enactments, the Natural Gas Act (1938), the Administrative Procedure Act (1946) and the

Department of Energy Organization Act (1977), with pertinent amendments and regulations, as well as the Constitution, Amendment Five.

In our conversation you confirmed that one of the areas the Subcommittee wished to explore was the details of the negotiations with Sonatrach -- "who proposed what to whom." It is obvious from the wording of the show cause order that this issue and the general subject of negotiations with Sonatrach are at the heart of the FERC show cause proceedings. These very matters will be in issue in determining whether or not Trunkline LNG Company's certificate has been "violated". I need not remind you, allegation of a violation of a Commission Order under the Natural Gas Act is a serious matter. This issue must be left for the quasi-judicial proceedings being conducted by the agency designated by Congress under applicable law.

You indicated that my requests were not feasible and stressed that the Subcommittee had no intention to delve into the merits of the proceeding. I readily conceded that we did not question the Subcommittee's intent. Our concern, however, is to avoid any possibility of infection of, or interference with, the administrative process in the quasi-judicial determinations specifically delegated to the agencies by Acts of Congress under the Constitution.

Because of our concern, we request that the Subcommittee reconsider its planned hearing and grant our requests. I rely on you to communicate these requests to the Subcommittee.

Yours very truly,

Harry S. Welch

Harry S. Welch

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CHIEF COUNSEL AND STAFF DIRECTOR

United States Senate

COMMITTEE ON
GOVERNMENTAL AFFAIRS
SUBCOMMITTEE ON ENERGY, NUCLEAR
PROLIFERATION AND GOVERNMENT PROCESSES
WASHINGTON, D.C. 20510

July 28, 1983

Mr. Harry S. Welch
Senior Vice President
and General counsel
Panhandle Eastern Corporation
P.O. Box 1642
Houston, Texas 77005-4098

Dear Mr. Welch:

I have been informed by Mr. William Strauss, Staff Director and Chief Counsel of the Subcommittee on Energy, Nuclear Proliferation and Government Processes of your request that the Subcommittee cancel its plans to have government representatives testify at its forthcoming hearing on natural gas imports. You have also requested that the Subcommittee postpone or cancel its request that a representative of Panhandle Eastern Corporation appear. After Panhandle Eastern accepted my invitation to appear, the Federal Energy Regulatory Commission (FERC) issued an order on July 18 reopening a proceeding in which Panhandle is a party. I share your determination to ensure the integrity of any orders which might issue from the FERC in that proceeding.

Government management of natural gas imports is a serious public problem. Unwarranted increases in natural gas prices are a matter of pressing concern to me as a representative of the people of Illinois and as a Member of United States Senate. In my view, the Subcommittee's investigations and occasional hearings are an appropriate exercise of its legislative and oversight responsibilities. At its forthcoming hearing, the Subcommittee intends to review issues affecting natural gas imports which are particularly timely, since the Senate may in the near future take legislative action on these issues.

For this reason, I find it regrettable that Panhandle has requested not to testify before the Subcommittee. I believe that Panhandle Eastern is abandoning an important opportunity to present its views on these issues before a Subcommittee of the Senate with responsibilities in this area.

After I invited Panhandle to testify at this hearing, the FERC issued a show-cause order on the matter of the Trunkline contract. It would be simple and straightforward to ensure that neither your prepared testimony, nor questioning of you by Members of the Subcommittee, would interfere with your rights in this case. However, I would like to make sure that all parties to this action, including Panhandle, have total confidence in the fairness of those proceedings.

Therefore, while I welcome your testimony, I have decided to grant your request to be excused from appearing before the Subcommittee. You may be sure that the questioning of any government witnesses will be done in such a way as not to prejudice the matter now pending before FERC.

Sincerely,

Charles H. Percy
United States Senator

CHP:arj

August 2, 1983

The Honorable Charles H. Percy
United States Senate
Committee on Governmental Affairs
Subcommittee on Energy, Nuclear
Proliferation and Government
Processes
Washington, D. C. 20510

Dear Chairman Percy:

Thank you for your letter of July 28, 1983. We appreciate your recognition of the need to maintain total confidence in the fairness of the regulatory proceedings.

Mr. Kenneth E. Kalen has asked me to tender his prepared statement as President and Chief Operating Officer of Panhandle Eastern Pipe Line Company and Trunkline Gas Company which he would have given on July 29, 1983 had the Subcommittee's invitation to testify not been superseded. Accordingly, I enclose a copy of such statement and request that it be formally incorporated in the record. Copies of the same statement, dated July 29, 1983, were delivered to the Subcommittee staff prior to the hearing and are, therefore, already among your informal files.

Sincerely,

Harry S. Welch

Harry S. Welch

HSW:jt
encl.
cc: William A. Strauss, Esq.

Statement by
Kenneth E. Kalen, President, Chief Operating Officer
Panhandle Eastern Pipe Line Company
Trunkline Gas Company

Subcommittee on Energy, Nuclear Proliferation
Committee on Governmental Affairs and Government Processes
United States Senate

Washington, D.C.
July 29, 1983

Mr. Chairman and members of the Committee.

My name is Kenneth E. Kalen. I hold the position of President and Chief Operating Officer of Panhandle Eastern Pipe Line Company (PEPL) and Trunkline Gas (Trunkline), the two interstate transmission subsidiaries of Panhandle Eastern Corporation.

On behalf of the management and employees of Panhandle Eastern, I am pleased to respond to the request of the Chairman to provide the Committee with our perspective on the important role imported natural gas has, and will continue to have, in meeting the needs of consumers and of industry and commerce in our market states for a reliable supply of natural gas for the long-term future. My testimony will cover the origin and present status of the two imported gas supply projects

Panhandle Eastern has in operation -- purchases from Canada and Algeria. And, finally, my statement will discuss some of the issues raised by legislative proposals aimed at establishing specific economic criteria for the purchase of natural gas from foreign nations.

The combined Panhandle/Trunkline transmission system operates 17,100 miles of pipeline which is devoted to delivering natural gas under long-term contracts to 130 investor-owned and municipal distribution systems serving portions of 12 states with a population of approximately 24 million people. The primary market covers large portions of Michigan, Ohio, Indiana, Illinois and Missouri. Approximately seven million gas meters, or 14 percent of the total in the United States, are served directly or indirectly by our combined pipeline system.

Throughout its 54-year history, Panhandle Eastern has given a consistently high priority to long-term gas supply. Although changing regulatory and economic developments have been and remain a material influence, the adequacy of supply under contract to our pipelines to meet their long-term service obligations to customers has been, and is today, the driving force for our strategic operating and investment decisions.

It was, therefore, no accident that our strategic planning in the late 1960s and early 1970s identified Canada and Algeria as potentially important sources of long-term

supply for our market area. A brief historic summary will demonstrate why we concluded then and continue to believe today that the United States must have access to foreign gas production to supplement domestic supply.

By 1970, the United States was experiencing the bitter fruits of the first 16 years of Federal regulation of wellhead prices for natural gas production moving in interstate commerce. Domestic exploration had been on a downward curve since 1956 (Exhibit 1). In 1968, the amount of reserves added in the lower 48 states fell below production for the first time in history -- a deficit condition which has prevailed to the present time with the exception of 1981 (Exhibit 2). In 1971, our pipelines were compelled to institute their first curtailment of deliveries to customers -- a condition which was experienced by many other interstate pipelines and which continued with increasing severity for the industry through 1978.

Shortage had become the dominant circumstance for consumers supplied by interstate pipelines. The primary focus of the business strategy that emerged in response was developed in continuous consultation with our utility customers. Extensive data was provided by customers with respect to their current and future needs for gas. That consultation has continued and is extremely important to our business decisions today.

The low point of supply was reached during the bitterly cold winter of 1976-77 when factories and schools were forced to close in several states because there was not enough gas flowing in interstate pipelines to meet requirements.

During the six-year period ended in 1976, sales on the Panhandle-Trunkline system declined 30 percent, solely because of the deficiency in gas supply (Exhibit 3). During the same period, the amount of reserves added in the lower 48 states was equal only to 47 percent of production.

The supply condition for Panhandle Eastern and other interstate systems was precarious. According to data compiled by the Energy Information Agency,* the total of reserves under contract to interstate pipelines dropped from 173.6 Trillion cubic feet (Tcf) in 1970 to 98.3 Tcf in 1976 -- a decline of 56 percent (Exhibit 4).

For our pipeline system, reserves under contract declined by 49 percent in the 1970-75 period (Exhibit 5).

Commencing in 1970, my Company initiated, and vigorously pursued with customer support, a wide-ranging gas acquisition program to the maximum extent of our resources. During the period of 1970 through 1982, Panhandle Eastern Corporation and its subsidiaries invested $3.4 Billion in gas supply projects, initially aimed at terminating curtailments as quickly as possible and, concurrently, to rebuild a reserve

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* Commencing in 1978; this data previously was compiled and published by the Federal Power Commission.

base that would provide greater assurance of reliable future service to our market. Virtually all of our customer requirements were satisfied in 1979 and curtailments were formally ended in March 1980. And as we began 1983, our pipeline reserves stood at 9.7 Tcf compared with 6.9 Tcf in 1976.

The reserve improvement reflects both the success of our domestic acquisition program and the addition of the 3.3 trillion cubic feet of gas covered by the Algerian gas purchase contract and the 300 billion cubic feet covered by the Canadian gas purchase contract (Exhibit 5). Together, these foreign contracts represent about one third of our pipeline reserves at the present time.

In the early 1970s our strategic studies of future gas availability, together with data from independent sources, clearly established the need for supplemental sources of gas supply for the 1980s and 1990s.

There was in the early 1970s, just as at the present time, considerable uncertainty about the content of public policy for natural gas -- the key factor governing the exploration and development of reserves in the United States.

Given the prevailing regulatory circumstances and fully cognizant of its long-term market obligations, Panhandle Eastern embarked on the development of several supplemental gas supply projects. These included gas from Alaska, coal gasification and imports from Canada and Algeria.

Up to now, coal gasification and Alaskan gas have not matured. My Company has charged against income $73 Million of costs associated with the Alaskan pipeline project and coal gasification through 1982.

Before describing the status of each of our operating imported supply sources, I must emphasize to the Committee the fact that each of these projects received prior regulatory approval pursuant to the provisions of the Natural Gas Act. Each was subjected to a rigorous examination in extended public proceedings from which the Federal Power Commission or its successor, the Federal Energy Regulatory Commission (FERC), concluded that each project would serve the present and future public convenience and necessity.

Customer participation and support was particularly strong in the hearings involving the LNG project. There is extensive evidence in the Federal Power Commission record, showing customer recognition that the indicated LNG price was then above the tightly regulated wellhead prices. Long-term supply was the issue that dominated the evidence. In this regard, I bring to your attention a statement filed by the Illinois Commerce Commission on June 14, 1977. The Illinois Commission said in support of the project:

> "The Commission considers the proposed LNG supply to be one replacing the dwindling domestic gas supply and therefore, to be meeting the continuing requirements of all existing consumers, not just industrial consumers."

As members of the Committee are aware, the Canadian project was also subjected to the scrutiny of Congress in connection with its legislative authorization of the overall Alaskan gas pipeline. Thus, the Northern Border Pipeline, which developed as an integral link in the overall Alaskan pipeline, has an impeccable regulatory pedigree. Northern Border transports the Canadian gas to Panhandle and three other pipelines. The Canadian purchase is made by Northwest Alaskan Pipe Line Company.

Through a subsidiary, Panhandle Eastern has a 22.75-percent equity interest in Northern Border. Our basic gas purchase contract provides for the purchase of 55 billion cubic feet annually. Pursuant to conditions attached in 1980 by the FERC to the Northwest Alaskan certificate authorizing the import, Panhandle had a take-and-pay obligation of 72 percent of annual contract quantity when gas began to flow in the Northern Border system in September 1982. This take-and-pay obligation increased to 82 percent on April 12, 1983 when the Canadian government reduced the border price to $4.40 per million Btu (MMBtu). The increased take-and-pay obligation resulted from the fact that the FERC certificate established a dollar ceiling on payments for gas imported from Canada, hence more gas purchases were required when the unit cost was decreased.

Pursuant to negotiations conducted between January and May of this year, involving U. S. pipeline buyers, the Canadian pipeline and producers, the National Energy Board of Canada and the Alberta government, the Canadian minimum purchase obligation has been reduced to 40 percent of the contract quantity for 1983 and 1984. The net effect of the purchase modification and the border price reduction made in April has reduced Panhandle's cost of Canadian gas through October, 1984.

Although these contract changes are subject to approval by government agencies in the United States and Canada, Panhandle Eastern has already passed the resulting reduced costs to its customers as part of its overall 14 percent rate reduction, which became effective on June 1.

As you may be aware, the Canadians made another price reduction to $3.40 per MMBtu on July 6 but tied the lower unit price to purchases above 50 percent of contract levels. This reduction will not affect Panhandle Eastern because our operating plan for the balance of this year and through October of 1984 calls only for the revised minimum purchases from Canada.

We are encouraged by the actions our friends in Canada have taken and hope they will take additional action to make their export prices more compatible with U. S. market conditions.

Our second and considerably larger imported supply involves the purchase of liquefied natural gas (LNG) from Algeria.

As the Committee is aware, the Federal Energy Regulatory Commission has reopened the proceedings involving the LNG imports through the issuance of its show cause order on July 18. In view of this development, it is not appropriate for me to discuss in detail the substantive issues which are the subject matter of the show cause order. Respondents Trunkline Gas Company and Trunkline LNG Company will file their response to the FERC order by August 2.

While we are restrained from a detailed discussion of LNG, we believe it important for the Committee to be informed of our present analysis of future supply availability for our market area.

The data displayed on Exhibit 6 demonstrates the future need for supplies beyond those available to our pipelines from presently contracted sources. This Exhibit portrays the future deliverability from reserves under contract at January 1, 1983.

Natural depletion is an inescapable dynamic of gas supply. Exhibit 6 shows that domestic deliverability for our pipeline systems will decline from approximately 900 Bcf in 1983 to below 500 Bcf in 1987 -- four years away.

Under the assumptions used, the Panhandle-Trunkline system will experience a supply deficit in this decade, growing progressively larger into the 1990s. This deficit is more pronounced if the imported gas supply is removed.

While we recognize and have every intention to honor our service obligations to customers in the years ahead, the gas supply situation is again displaying a wide range of uncertainties.

Reserve additions for the years immediately ahead are most likely to be less than desired because of the drastic slump in domestic drilling that began early in 1982 and continues today (Exhibit 1). The dominant uncertainty, however, relates to public policy on natural gas pricing, now the subject of debate in and out of the Congress.

While the data demonstrates the need for imported gas for the long-term, the current political debate has focused primarily on price -- and short-term price at that. Price is a valid concern for all of us, but concentrating upon imports as the culprit is tantamount to killing a fly with a sledgehammer.

Over the last ten years the volume of imports has accounted for about five percent of U.S. gas supply and approximately ten percent of the rates paid by consumers.

When assessing the behavior of gas rates in the United States since 1978, the inescapable truth is that the provisions of the Natural Gas Policy Act are responsible for the preponderance of the increases experienced by consumers. In our judgement, the economic incentives of the NGPA were vital and necessary and higher prices were the inevitable consequence.

The NGPA price mechanism, together with the changing mix whereby higher cost gas replaces depleting volumes of lower cost gas, completely accounts for the rate increases put in place by our pipelines for the period 1978 through 1982. The cost of domestic gas purchases increased 291 percent for Trunkline and 376 percent for Panhandle during this period.

The cost of imported gas -- purchases from Canada -- first entered the rates of Panhandle Eastern last October. The cost of LNG first entered the rates of both of our pipelines in March 1983.

While we urge prudent evaluation of any proposed legislative or regulatory action with respect to any possible adverse impact upon long-term supply, we are not oblivious to the current furor raised over increased natural gas prices.

As a Company, we are concerned about the impact of higher gas prices on those consumers experiencing hardship. During this past winter, for example, we made substantial shareholder contributions to private energy assistance programs in several of our market states.

And we have taken several actions to reduce our rates within the limits created by gas purchase contracts and regulation. Effective June 1, the rates of Panhandle Eastern were reduced by 14 percent, which amounts to an annual savings of $96 for the average domestic consumer in our market area.

In filings made eleven days ago, our pipelines proposed an additional but modest reduction in rates to be effective on September 1.

We have also developed a special industrial marketing program to provide gas competitively priced with residual fuel oil. This project, known as the PanMark Gas Company program, is pending FERC approval. Maintaining the highest possible level of industrial sales helps insure lower rates for all consumers.

Additionaly, we have requested producers supplying our system to defer well drilling or other activity which would have the effect under the NGPA of increasing gas costs. All of the market out clauses in our contracts that could be exercised, have been exercised.

I must put the Committee on notice, however, that the rate reductions indicated to be effective this coming September, if the filed rate plan is approved by FERC, are about as far as Panhandle Eastern and Trunkline can go in the near-term within the prevailing regulatory and contract restraints.

We are moving ahead with our broad program of internal cost control and with contract renegotiation with domestic producers. The major benefits of successful negotiations, however, will largely be confined to a reduction in take-or-pay obligations.

There is little likelihood that any significant reduction in wellhead prices can be achieved in bilateral discussions with producers. Contract revision, it must be remembered, is a two-way street -- a controlling circumstance not often acknowledged by those criticizing the pipeline industry these days. Unfortunately, our pipelines have little to give in exchange for wellhead price reduction. We have by no means given up on achieving voluntary price reductions, but developments to date are not encouraging.

I will conclude this statement with some observations about the various proposals introduced in the Congress with respect to foreign sources of gas supply. Those proposals fall into two broad categories -- those that seek specifically to revoke our LNG import authorization and those that establish economic criteria for the pricing of all imported gas.

With respect to the former, we take the position that revocation by statute must, in fairness, include complete recovery in a reasonable time for the LNG investment, including the cost of American built tankers. Since these investments

were made pursuant to lawful regulatory approval of the project, any legislative or regulatory action having the effect of cancelling this project must, in fairness, include full cost recovery.

We are not advocating that Congress take such action. In fact, such legislation conveys a grave threat to other major energy projects which could fall into public disfavor. Moreover, legislation of this type would send a clear signal that the United States is an unreliable trading partner.

With respect to the second category of proposed legislation, namely, setting a price ceiling for imported gas, the Congress again flirts with grave danger in attempting to define pricing formulas which will serve satisfactorily over time. The present anger in some quarters over imported gas prices ought not be allowed to be the basis for public policy.

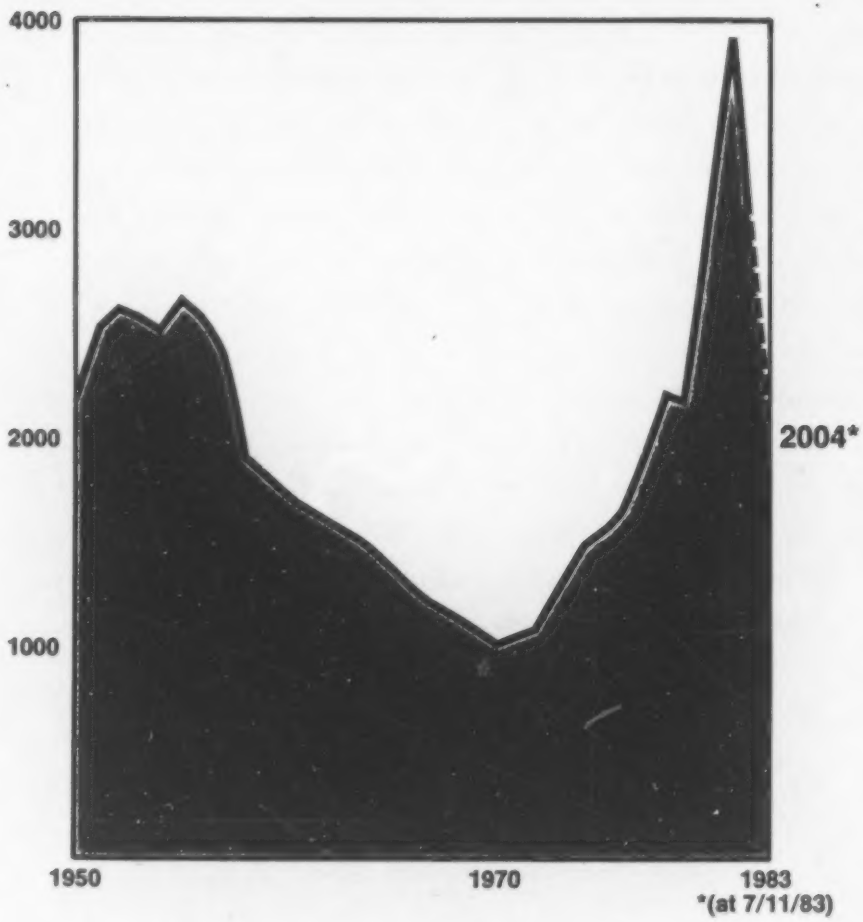
Hindsight is infallible. Foresight is fragile. A wiser course, it would seem, would be to permit the present arrangement to function under which the appropriate regulatory agencies can make deliberate judgements on imports. The United States should preserve and expand its options for future energy supply rather than narrow opportunities.

That concludes my presentation, Mr. Chairman.

Exhibit #1

Domestic Exploration

Average Annual Drilling Rig Activity
Lower 48 States



Source: American Petroleum Institute

Exhibit #2

Annual Reserve Additions and Production

Lower 48 States (Tcf/Year)

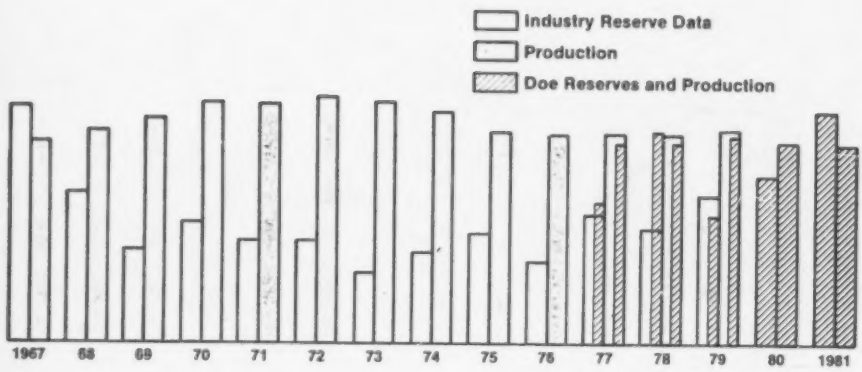


Exhibit #3

Consolidated Gas Sales

Panhandle Eastern Pipe Line Company
Trunkline Gas Company

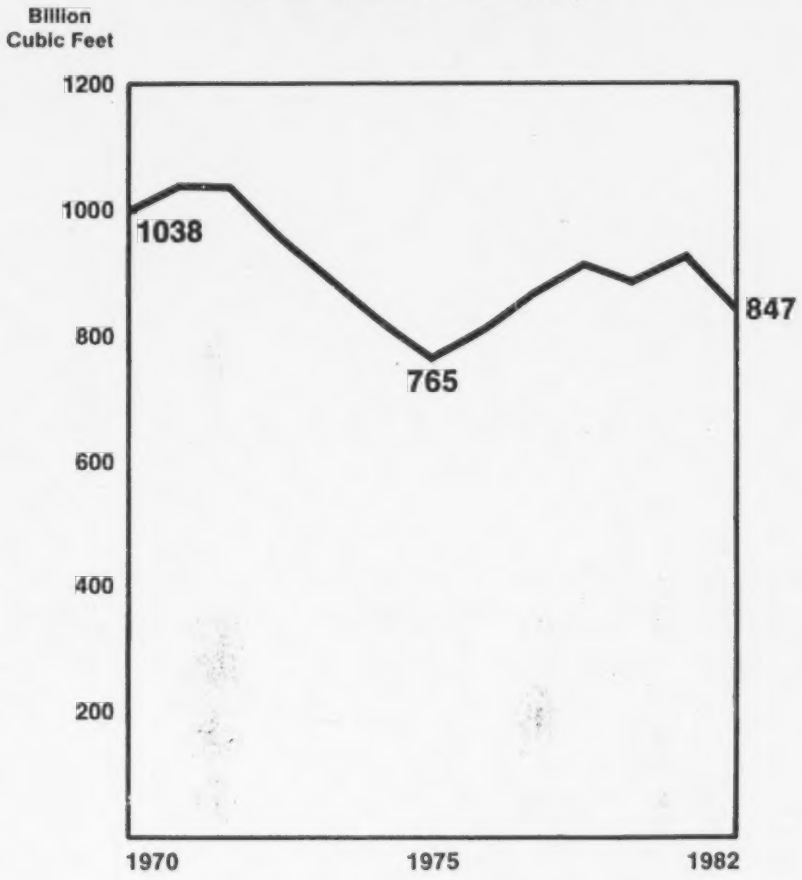
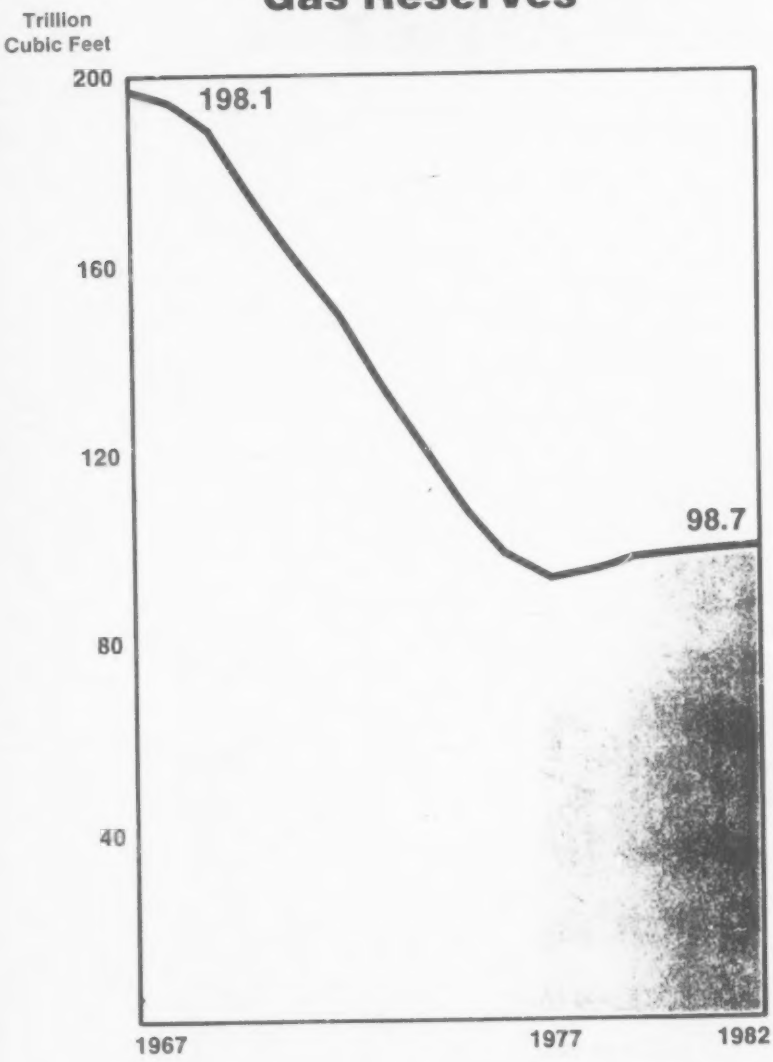


Exhibit #4

Interstate Pipelines Gas Reserves



Source: DOE/EIA

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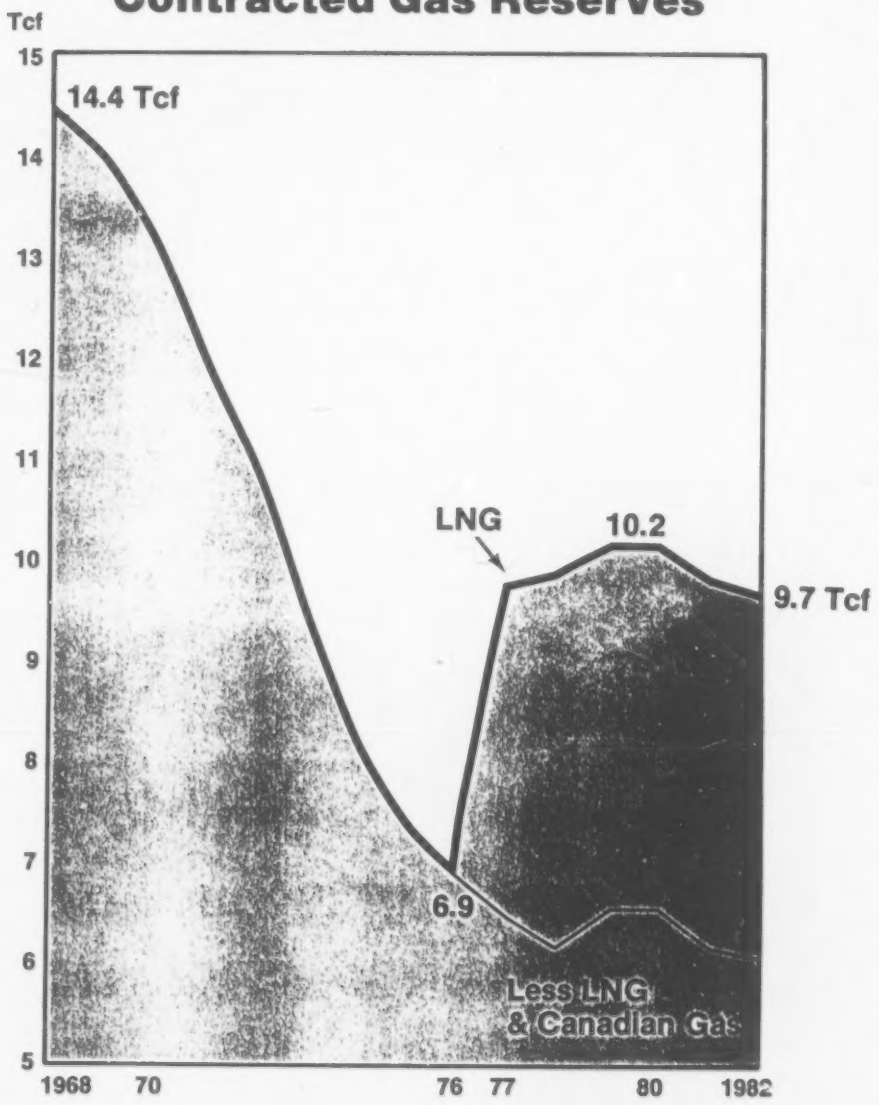
Exhibit #5

Panhandle Eastern Pipe Line Company
Trunkline Gas Company

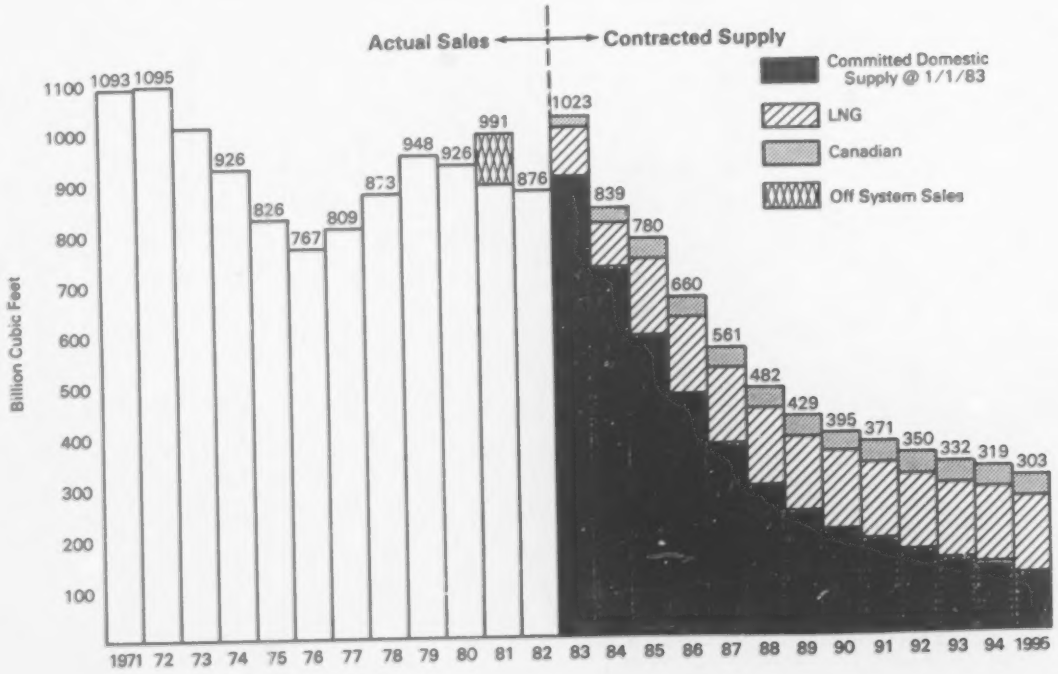
Contracted Gas Reserves



Panhandle Eastern/Trunkline Gas Company

Committed Volumes Available For Sale

Volumes BCF @ 14.73 (SAT.)



STATEMENT FOR THE HEARING RECORD OF
C. M. BUTLER III
CHAIRMAN, FEDERAL ENERGY REGULATORY COMMISSION
BEFORE THE
SUBCOMMITTEE ON ENERGY, NUCLEAR PROLIFERATION
AND GOVERNMENT PROCESSES
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

Thank you for affording me the opportunity to submit this statement for the record of your hearings on gas import policy. I share your concern with the seriousness of the problems, and commend the Subcommittee for exploring them.

In your letter of July 27, 1983, you have asked me to present my views as to the Federal Energy Regulatory Commission's (FERC) role in natural gas import policy in light of current market conditions and future import authorizations. As Administrator Hanzlik indicated in response to your questions at the July 29 hearing, he and I have met on several occasions to discuss the allocation of Natural Gas Act (NGA) jurisdiction over imports. Inasmuch as the present allocation of NGA section 3 authority -- to both the FERC and the Economic Regulatory Administration (ERA) -- is derived from delegations and assignments of the Secretary of Energy's authority, any revision of that present allocation (absent new legislation) would presumably be in the form of revised delegation orders. Administrator Hanzlik testified that he anticipates that a resolution of this matter may occur in September. Pending such an occurrence, it is very difficult for me to forecast what the Commission's future role in the gas import regulatory process will be.

In his testimony, Administrator Hanzlik correctly summarized the jurisdictional problem as one arising from enactment of the Department of Energy Organization Act (DOE Act). Previously, the Federal Power Commission (FPC) exercised comprehensive regulation of natural gas import projects under sections 3, 4, 5 and 7 of the NGA. The DOE Act split off section 3, transferring it to the Secretary of Energy, while placing sections 4, 5 and 7 within the jurisdiction of the FPC's successor, the FERC. In my statement submitted for the Subcommittee's February 28 hearing, I described at length the problems that arose from this split. They could be summarized as follows.

Prior to enactment of the DOE Act in 1977, all authority under the NGA to approve natural gas import projects was consolidated in one agency, the FPC. Under section 3 of the NGA, the FPC considered whether the import itself was not inconsistent with the public interest. Under section 7 of the NGA, the FPC considered whether the interstate transportation and sale for resale of that gas within the U.S. was in the public interest, as well as whether construction of new pipelines or compressors for that purpose was in the public interest. And under sections 4 and 5 of the NGA, the FPC approved tariffs governing the sale and transportation of the gas within the U.S., including cost passthrough and "take-or-pay" arrangements.

Thus, in considering an import project, the FPC would consider the cost of transportation and the cost of new construction (if any), as well as the price of the gas at the border, in determining whether the gas was needed and could be marketed at its ultimate destination. Similarly, in approving the "take-or-pay" and other financial arrangements in the import contract, the FPC would consider the comparable arrangements governing the sale of the gas after it crossed the border. Such comprehensive consideration of financial arrangements was often essential to the financing of such projects in that lenders and investors needed asurance of the pass-through of revenues.

The DOE Act did not change any of the substantive requirements of the NGA; rather, it cleaved those requirements in two, allocating some to the Secretary of Energy and some to the FERC. Moreover, the DOE Act and its legislative history are less than clear as to precisely where the ax fell. Sections 301(b) and 402(a) clearly transferred section 3 of the NGA to the Secretary, while clearly transferring sections 4, 5 and 7 of the Act to the FERC. But in addition, section 402(f) of the DOE Act transferred to the Secretary exclusive jurisdiction to regulate imports and exports of gas. Inasmuch as section 3 of the NGA had already been transferred to the Secretary by virtue of sections 301(b) and 402(a) of the DOE Act, the question arising was whether section 402(f) of the Act was intended to transfer to him something more -- i.e., authority to approve, under sections 4, 5 and 7 of the NGA, the domestic arrangements necessary to facilitate an import.

At the time the DOE Act was enacted, there were four major proposed LNG projects pending before the Secretary and the FERC, and the possibility of imports from Mexico was on the horizon. The LNG cases were heavily contested and likely to end up in court. Given the ambiguities in the DOE Act, and recognizing that it authorized the Secretary to delegate his authority to the FERC but did not authorize the FERC to delegate its authority to him, Secretary Schlesinger sought to clarify the jurisdictional division by issuing a pair of delegation orders (one to the ERA and one to the FERC) that clearly allocated to the FERC (in case it didn't have it already) all NGA section 4, 5 and 7 authority ancillary to imports, 1/ while allocating to the ERA primary jurisdiction to approve imports under NGA section 3. The orders did succeed in clarifying who had jurisdiction over what, as well as avoiding court challenges over jurisdiction. But since there are overlapping considerations under section 3 and sections 4, 5 and 7 of the NGA, the jurisdictional split has left each agency incapable of comprehensively analyzing and regulating gas imports, or even deciding discrete issues under the respective delegation orders with finality.

When the Departments of Energy and State jointly negotiated a gas import project with Mexico, for instance, the negotiators could not bind the FERC to implement it (although the FERC did

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1/ An exception to this jurisdictional split was created by a third delegation order, which in effect delegates to the FERC all section 3 jurisdiction to approve imports through the Alaska Natural Gas Transportation System.

very quickly thereafter approve the necessary transportation and sale arrangements). With respect to the Trunkline LNG project in Louisiana, the FERC is responsible for considering the pass-through of the cost of the gas, while the ERA considers the import of that gas at that price. With respect to Canada, the ERA considers the price of gas at the border, while the FERC must consider the need and market for the gas at its destination, including the cost of constructing new facilities to import it.

The FERC has, in fact, implemented the gas import policies of the Secretary of Energy in all instances in which such policies have been clearly established. Nevertheless, the present jurisdictional split is inherently clumsy; it hamstrings the ability of the U.S. government to speak and act decisively in its regulation of imports.

I firmly believe that all regulatory authority over gas imports ought to be consolidated into a single decision-making entity. This can be accomplished in one of two ways. First, all regulatory authority under sections 3, 4, 5 and 7 could be consolidated in the FERC through delegation of the requisite section 3 authority, with the Secretary of Energy retaining the authority to determine the country's foreign policy and national security interests in proposed imports and exports and, to implement such determinations, the authority to exercise a veto over import proposals. Under this approach, the Commission would be precluded from approving or disapproving a proposed import or export until after the Executive Branch has made a

determination of whether it is consistent with the national security and other foreign policy interests of the United States. If the Executive Branch makes a negative determination, the Commission would be required to disapprove the application. This approach would preserve the Executive Branch's prerogative to decide the impact that an import or export would have on our foreign policy. All other aspects of the import proposal, including approval (or disapproval) of the price and volumes of gas to be imported, should then fall within the comprehensive jurisdiction of the Commission.

Alternatively, the existing delegation orders could be revoked, with sections 3, 4, 5 and 7 authority over imports and export delegated to the Administrator of the ERA. As noted above, there is some question of whether the DOE Act in fact authorizes such a delegation. However, I believe that valid arguments exist which could support such a transfer. There are two practical problems connected with the latter approach. The first is ERA's relative lack of expertise in dealing with rate issues under the Natural Gas Act. The other is that ERA decisions may well fail to coordinate with rate decisions made by FERC in an importing pipeline's general rate proceedings.

I believe either of the above approaches, although not perfect, would be a vast improvement over the existing arrangement. Placing all regulatory authority into a single agency would eliminate the existing jurisdictional overlap between the ERA and the FERC, and add a degree of rationality to the natural gas market to the extent that is possible under the existing regulatory framework.

WRITTEN STATEMENT OF
THE ASSOCIATION OF BUSINESSES
ADVOCATING TARIFF EQUITY
BEFORE THE SUBCOMMITTEE ON ENERGY,
NUCLEAR PROLIFERATION AND
GOVERNMENT PROCESSES OF
THE SENATE COMMITTEE ON GOVERNMENT
OPERATIONS

July 27, 1983

The Association of Businesses Advocating Tariff Equity ("ABATE") is pleased to submit this written statement concerning the continued importation of Algerian Liquefied Natural Gas ("LNG") by Trunkline LNG Company ("TLC") and its affiliates Trunkline Gas Company ("Trunkline Gas") and Panhandle Eastern Pipe Line Co. ("Panhandle"). ABATE believes that there is a pressing need now to review this import project and to examine its present and future impact on the United States.

Description of ABATE

ABATE is a voluntary association of businesses which are located in and doing business in the State of Michigan. The purposes of ABATE are to advocate to the Michigan Public Service Commission and to other regulatory bodies having jurisdiction over public utilities and natural gas pipelines, the establishment and adoption of utility and energy rates, terms and conditions of service and other tariffs or contracts governing the provisions of utility and energy services, which are just and reasonable, non-discriminatory, nonpreferential, equitable, and based on the cost of providing service to each class of utility ratepayer. ABATE has been formed for the express purpose of participating in regulatory proceedings, advocating, making known and protecting the interests of businesses in connection with energy and utility matters in pursuance of such purposes. Each member of ABATE has expressly subscribed to the purposes just described.

Members of ABATE include the following companies: Abitibi-Price Corporation, The Budd Company, Bundy Corporation, Chrysler Corporation, Clark Equipment Company, Detroit Strip Division of Cyclops Corporation, Dundee Cement, Eaton Corporation, Edward C. Levy Company, Escanaba Paper Company, Ford Motor

Company, General Motors Corporation, Great Lakes Steel Division of National Steel Corporation, Haworth Inc., Hayes-Albion Corporation, Huron Valley Steel Corporation, James River Corporation, Kastle Steel Corporation, Marblehead Lime Company, Menominee Paper, McLouth Steel Products, Michigan Sugar Company, Monitor Sugar Company, National Standard, Pennwalt Corporation, Quanex Corporation, Steelcase, Inc., T.R.W. Corporation, and Wolverine Aluminum.

Impact of the Trunkline LNG Project on ABATE

LNG supplied by TLC is purchased and resold for ultimate consumption in the upper Midwest by Trunkline and Panhandle. Substantial volumes of LNG are thus supplied to Michigan distribution utilities which serve the members of ABATE. These distributors include Consumers Power Company, Michigan Consolidated Co., and Michigan Gas Utilities.

The enormous cost of Algerian LNG has a major financial impact on these distributors and thus on members of ABATE supplied by them. In the case of Consumers Power Co., for example, the LNG is said to constitute over 25 percent of that company's gas supply and members of ABATE in turn account for roughly 12 percent of all gas sales by Consumers Power. The ABATE customers of Consumers Power consequently were jolted by the enormous rate increases placed into effect on March 1, 1983, by Trunkline Gas and Panhandle due to LNG imports. Trunkline Gas increased its rates by $1.32 per dth due to LNG and Panhandle by $.41 per dth. (The actual rate increases on March 1 were even higher due to additional non-LNG costs.)

Rate increases of this magnitude at a time when competing fuel oil prices have actually been declining have lead to obvious results. As Trunkline and Panhandle themselves recently acknowledged, pipeline sales have declined dramatically. From 1982 to 1983 (the first year of rate increases due to LNG deliveries) Trunkline's sales are projected to plummet from 526 Bcf to 334 Bcf or over 35 percent. Panhandle's sales will decline from 616 Bcf to 454 Bcf or over 25 percent. */

As a result, Panhandle and Trunkline are now faced with "exponential additions" to their potential liability for take-or-pay payments to domestic U.S. producers which "could well be over

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*/ Pan Mark Gas Co., FERC Docket No. CP83-333-000, Abbreviated Application for Certificate of Public Convenience and Necessity, dated May 23, 1983 at pp. 8-10.

$1 billion by the end of 1984." */ Consequently, the two pipelines are reducing prices paid for some categories of high-priced domestic gas while they continue to purchase high-priced LNG.

For these reasons ABATE has been an active party in administrative proceedings before the Federal Energy Regulatory Commission ("FERC") and the Economic Administration ("ERA") to review the Trunkline LNG project. In the proceedings last fall and winter, ABATE proposed that the LNG project be mothballed and that TLC be permitted to recover its prudently incurred fixed costs, a return of equity, and a reasonable return on equity. In the event that the FERC and ERA failed to adopt this solution, ABATE further advocated as one alternative solution to the problem of high priced LNG imports that TLC be required to renegotiate the LNG price with Algeria. In their February decisions, FERC and ERA ordered TLC to renegotiate as proposed by ABATE.

The July 3 Agreement
Between TLC And
Sonatrach Is Inadequate

TLC has recently reported that renegotiation between TLC and Sonatrach was completed by an agreement reached between the parties on July 3, 1983. TLC's Special Report No. 2 to the FERC in Docket No. CP74-139-000 dated July 7, 1983, describes this agreement. ABATE believes that the July 3, 1983 agreement is inadequate. In fact, it is ABATE's view that TLC and Sonatrach have failed to renegotiate as required by both the contract and the orders of the FERC and ERA and that the project must be suspended.

ABATE intends to advance legal arguments in support of its position in the show cause proceeding initiated by the FERC's order of July 18, 1983 in Docket No. CP74-138-010. In brief, ABATE believes that: (1) Article XXIV of the LNG Contract requires the parties to renegotiate the LNG price consistent with "current economic) conditions in the 'East Coast' and 'Gulf Coast' Regions;" (2) that failure to do so is adequate grounds for the FERC to revoke TLC's certificate and for ERA to revoke TLC's import authorization under Sections 3 and 7 of the Natural Gas Act; and (3) that the July 3 agreement and the events that lead up to it violate the contract and justify revocation of the certificate and import license.

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*/ Id.

**/ Id. at 10-11.

In its Brief to the FERC and ERA in January, ABATE stated that the LNG price was unreasonable and that the LNG price at the tailgate of the conditioning plant would have to be reduced by at least $1.50 per MMBtu to compete with No. 2 fuel oil and $3.00 per MMBtu to compete with No. 6 fuel oil and other available domestic gas supplies. */ TLC's Special Report No. 2 now contains ample evidence that substantial price reductions are needed to make LNG competitive with No. 6 and No. 2 fuel oil.

Despite these developments, Algeria has insisted that the parties adhere to a pricing amendment negotiated almost a year ago -- so-called Amendment No. 1 -- and TLC has apparently agreed to Algeria's demand. Although this amendment may result in a temporary modest price reduction, this reduction is woefully inadequate. Over the long term, moreover, the amendment will surely lead to higher, not lower, LNG prices. As a result, LNG will continue to be priced substantially higher than competing fuels and will continue to be unmarketable. More fundamentally, the parties have simply failed to adjust the LNG price to current market realities as the contract requires and as the FERC and ERA have ordered. The outcome therefore represents a failure of the renegotiation process.

The FERC and ERA Should Promptly Suspend This LNG Import

The FERC has already instituted a show cause proceeding. To date ERA has done nothing although it promised to review the LNG price within six months when it issued Order No. 50 in February. Both agencies should take prompt action now to protect U.S. gas consumers.

The FERC's show cause order implies that TLC and Sonatrach should subject themselves to international arbitration. ABATE submits that such a procedure would lead to interminable delays while LNG continues to flow at prices which harm both the pipelines and their customers. What is needed now is not arbitration, but decisive action by the U.S. The first complaints about the LNG imports were filed in August 1982. The FERC and ERA have done little in the ensuing year to protect U.S. consumers other than to require renegotiation. Nothing less than a forthright decision to suspend this project is needed immediately.

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*/ Brief at 19.

Legislation

In light of the failure of Administration action to force meaningful renegotiation, ABATE firmly believes that legislation is needed.

We generally support efforts such as S.370 and H.R.1441. The former subjects all liquefied natural gas to a cap tied to the price of Number Six fuel oil; the latter provides that all natural gas will be decertified within nine months unless renegotiated to assure that the price term meets "current market conditions".

ABATE believes that contracts which do not meet current market conditions should be renegotiated. H.R.1441 permits the FERC or ERA to decertify contracts where renegotiations cannot be achieved and is thus consistent with ABATE's position that the Trunkline LNG contract be decertified because the parties have failed to successfully renegotiate.

We understand that the Senate will soon be considering legislation to deal comprehensively with natural gas problems and that an amendment dealing with natural gas will be offered. We urge the members of this Subcommittee to support the effort to legislate a solution to this serious consumer problem.

STATEMENT OF THE INDEPENDENT PETROLEUM ASSOCIATION OF CANADA

BEFORE THE

SENATE GOVERNMENTAL AFFAIRS COMMITTEE

UNITED STATES SENATE

July 29, 1983

By the end of this decade imports from Canada could provide 10 - 15 percent of the natural gas supply for the United States consumers, two or three times today's volumes of about 800 Bcf a year, according to estimates of several United States forecasting firms and the Department of Energy. Today's supply surplus could be tomorrow's supply shortage, according to other experts. Both U.S. consumers and Canadian producers therefore have much at stake. While struggling to adjust price and supply to conditions today, parties in both countries must struggle with equal vigor to understand and protect each other's long-term interests. It is in this spirit that the Independent Petroleum Association of Canada (IPAC) is pleased to submit this statement.

IPAC represents 330 Canadian oil and gas producers and service companies, a large number of which are subsidiaries or partners with American companies. The welfare of every member of IPAC is intimately related to the oil and gas market in the United States. We have a stake in preserving that market for natural gas the same as American producers. IPAC has therefore taken a leadership role during the last year in reexamining the price and contract terms of gas moving into the United States. Along with the Alberta government, other Provincial

governments and the Canadian Petroleum Association, and with the cooperation of the Canadian Federal government IPAC last September launched an initiative aimed at insuring more flexible terms for gas sales into the United States. In January we visited with you, Senator Percy, and other leaders of the Congress, the regulatory agencies and the Executive Branch both to tell our side of the story and to understand yours. Returning to Canada, we launched our effort to introduce more flexible terms including the reduction of the price of gas to the United States and to install a two-part rate -- a base price and an incentive price for incremental volumes that is now in place. We are proud of this initiative. One reason we present this statement is to insure that the true dimensions of this accomplishment are understood. We also want to discuss the future. IPAC does not intend to rest on its laurels but is now beginning a second initiative to take the next step: to establish principles and prices for the time, 15 months from now, when the present regime expires. In fashioning our recommendations and policies we must know what the United States is doing to correct its own market conditions.

But before discussing the future or the recent past, let us begin with a clear understanding about where Canada and the United States have been since 1979 in natural gas trade. Let us review a few highlights concerning how the present pricing system and transportation network came into being.

These highlights can be summarized in this way:

First, the present system in which the price of gas is uniform at all parts of the border, was installed at the specific request of the United States in 1977. It is not market oriented since markets are not uniform from place to place. Prior to that time a pricing system based upon a demand and commodity rate was in place and reflected greater sensitivity not only to regional markets but to volume discounts as well.

Second, the present pricing system under which natural gas is priced in relationship to crude oil was negotiated between the United States and Canada in 1980 and represented a careful consideration of the issue by both countries. The United States had negotiated long and hard with Mexico over pricing natural gas in relationship to oil product and deliberately agreed to the present system based upon crude prices.

Third, Canadian exports have consistently been approved as reasonable in both price and volume by United States regulatory agencies and have incorporated features specifically requested by the United States, such as the "FERC formula" written into the PreBuild contract on April 28, 1980.

Fourth, the transportation systems which serve the United States from Canada have always been the subject of careful negotiation to achieve mutual benefit. They are modern, efficient, and for the most part, inexpensive. The exception for the moment from a cost standpoint is the transportation system built with the agreement of both countries to transport Alaskan gas to the United States. The high-cost of those facilities

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with its attendant impact on consumers in the Midwestern and South-Central states can be traced directly to the expectation of early and large volumes flowing from Alaska into the Eastern and Western legs of the PreBuild. These expectations were created by the United States.

Fifth, Canada has always been a supplier of the highest reliability and security for the United States consumers. During the supply crisis of the late 1970's, United States consumers received their full authorized volumes from Canada and did not suffer curtailment because of a lack of Canadian gas. A comparison of the experience of Michigan and Ohio during those years is ample evidence of the difference. Ohio was curtailed, sending workers and school children home for weeks, while Michigan, with Canadian gas, was not. And the reason is very simple: all Canadian gas was backed up by large reserves protected by long-term contracts and careful regulation. We stress this fact because it is important for the future. The producing life of Canadian reserves is three times greater than that in the United States when compared to current production, approximately 27 versus 9 years considering only conventional reserves and not Canadian frontier resources. Canadian contracts have been so reliable that during the entire history of the relationship only one instance of a curtailment can be discovered, when two reservoirs in northern British Columbia unexpectedly lost pressure. More prevalent are examples where Canada provided gas in an emergency. In 1977, on 24 hours notice, Canada provided

additional gas to the United States which shortly totalled 40 Bcf.

Sixth, the terms and conditions of the contracts now in place between United States and Canadian pipelines are the result largely of the supply shortfall of the 1970's and the corrections the United States made in 1978 to create incentives in the Natural Gas Policy Act. Had the United States not retained a supply of old gas, or had the United States a sufficient supply of new gas, pipelines would have had no reason to contact with Canada for volumes they now find an embarrassment of riches. Seeing the United States experience and fearing shortage of its own, Canadian regulators exercised considerable caution in authorizing exports and did so only after assuring themselves that the reserves were in place.

What becomes evident from this review, we suggest, is that the United States has acted very much as a partner -- some might say a senior partner acting in its own self-interest -- to define the volume, price and transportation system for trade in natural gas. Canada has likewise acted as a partner and the agreements have, on balance, reflected the mutual interest that is necessary for any long-term relationship to prosper. At the very least it should be clear that Canada has not acted unilaterally or forced upon the United States terms that were not advantageous to the United States.

Corrections in 1983

This brings us to the beginning of 1983, a time when United States consumers found prices rising at the same time that

supplies were in surplus, an anomoly that demanded correction. From the first IPAC recognized that it could not stand idlely by and wait for the United States alone to take action. It is our market too and we have an obligation to preserve demand for natural gas. At the same time IPAC understood that Canadian gas, representing five percent of total U.S. demand, seven or eight percent of demand in a state like Illinois, and no more than a third of demand in major consuming areas such as California, could not determine market terms and conditions. IPAC further recognized that fundamental natural gas policies must be accomplished in the United States by U.S. authorities.

As you know by now, on April 13th the Canadian government, with our encouragement and support, reduced the border price by 54 cents, to $4.40 U.S. per mcf. On July 6th a second reduction was announced, reducing the price on all volumes above 50 percent to $3.40, based upon 1981-1982 levels of exports or current contracts. In May Canada made a major concession on the volume of gas transported by the PreBuild facilities. What may not be known is what economic benefits United States consumers have received as a result of these reductions. We estimate that between April 13th and October 31st, 1983, United States consumers will save $118 million as a result of the 54 cent reduction and $123, primarily in California, as a result of the second tier reduction. In the contract year ending October 31st, 1984, United States consumers will save $326 million on the first tier reduction. The value of the second

tier reduction cannot be calculated so precisely since no one can be certain what volumes would be taken with or without the lower rate of how economic recovery or weather will influence volumes taken in 1984, however, we estimate that total savings will be at least equal the $123 million in the first year and could be as high as $400 million if 60 percent of Canadian gas under contract were taken.

Additional substantial savings have been transferred to U.S. consumers, including consumers in Illinois. On May 6, 1983 the parties in the PreBuild exports, both east and west, renegotiated their contracts to reduce the volumes taken to 40 percent of contract from 85 percent, the volume that would have been required under a formula imposed by the Federal Energy Regulatory Commission in the original agreement. As for volumes not taken, the parties agreed that Canada would receive only an interest-free loan in the amount of $1.98 U.S per mcf and that the United States could receive the gas later, at a time of expected supply shortfall.

IPAC estimates that from this agreement United States consumers will have saved $1.16 billion over two years (the length of the agreement) compared to the contract as written. These savings are in addition to those resulting from the discounting of the price at the border discussed above.

Other contract amendments have also been made. In general, for gas not taken under take-or-pay provisions in contracts for exports of Canadian gas, the price is fixed at the Alberta Border price plus transportation, and in some cases more generous

terms are in place. By contrast, nearly all U.S. contracts call for prepayments at the same level as gas taken, in some cases at very high levels, causing pipelines to shut in gas of a lower value.

Collectively all of these reductions have meant substantial savings to U.S. consumers. IPAC estimates that the total savings to the United States between April, 1983 and November, 1984, plus the additional savings in the PreBuild contract equal 1.85 billion. This represents a 25 percent reduction in the price of gas at the border compared to the volume and price conditions that existed at the beginning of 1983.

Every gain for U.S. consumers is a loss for Canadian producers. Employment in the Canadian oil and gas fields is down 40 percent in two years. The typical Canadian producer is producing only 40 - 45 percent of the gas under contract and these contract volumes are set under long-term reserve based contracts. Proportionately as many drill rigs are stacked in Canada as in the United States and bankruptcies and stretched financing are at least prevalent as in the States.

As producers IPAC know we are not alone is suffering from an oversupply of natural gas. Even more serious is the undersupply of money available to consumers, particularly the less fortunate, to pay for energy. But as we collectively struggle for a solution we ask you to remember that Canadian production or supply is not somehow immune from what you know to be true in this country and that our ability to produce for your future

is at risk. We also ask you to consider what Canada has accomplished to date and candidly compare it to events and conditions in the United States. Canada has reduced its natural gas income by 25 percent. If all U.S. producers had uniformly made the same reduction, would not the surplus of supply now be under control?

In Canada we read of Senators and Congressmen unwilling to counterance abrogation of domestic contracts, but have not the contracts for PreBuild gas been set aside for two years? We learn about lawsuits by major U.S. producers to force pipelines to continue to take volumes at contract levels, yet Canada has voluntarily reduced volumes as well as the price of gas above 50 percent of contract. The United States is unable to make pro-rata reductions in volume or to set a limit on prices without legislation, but Canada has done both.

One more aspect of the oversupply needs to be understood as it relates to Canada, particularly since it plays such importance in the future. We refer to the practice in the United States of selling gas based upon how much can be delivered at a particular time compared to Canadian practice of selling gas at a steady rate over the life of a contract, usually the life of a reservoir or field. This distinction is important because if the United States did not have a shortage in the 1970's, deliverability contracts would not have been written and today, instead of a surplus, the United States might well have a shortfall. The reverse is also true. Having created a surplus with deliverability contracts, the United States

stands in danger of a shortage when deliverability is expected to decline noticeably beginning about 1986. For example, wells operating on-shore in Texas in 1981 will produce only half the same volume of gas in 1986 and declines may be even more dramatic offshore.

It is this deliverability problem, not reserve additions as such, which confronts the United States in the second half of the decade. Reserve additions also will decline this year and next, given the fact that half the drill fleet operates today compared to peak development early in 1982, meaning that United States reserves will again be exhausted at 1970's rates. Thus, for both short and long range reasons the United States needs to encourage new supplies wherever they can be found and brought to the American consumer. Canada has such supplies. Last year the National Energy Board of Canada virtually doubled the volumes of gas available for export to the United States and additional reserves are being developed, both in the Western Provinces and Nova Scotia.

Looking to the Future

Because of the interdependence between United States consumers and Canadian suppliers, IPAC is convinced price and contract terms will be found which are satisfactory to both the United States and Canada. The pricing regime now in place expires in 15 months. As producers we are committed in the next phase to a pricing system which is based on market sensitive pricing.

We encourage a variable border price because markets are not uniform and should reflect conditions in each region. We believe in flexibility and would prefer to see more freedom for the contracting prices and a lesser role for governments in natural gas trade.

Within Canada the recent voluntary price reductions were achieved through a close working relationship between producers, Provincial governments and the federal government. IPAC is convinced the next phase will be characterized by the same cooperation. The United States government and the United States pipelines have been candid, forceful and constructive during the decision process just completed and Canadians look forward to reaching the next agreement in consultation and negotiation with them.

Knowing this, and believing that progress will be achieved, IPAC is concerned about legislation which was reported out of the Senate Energy Committee this week and about proposed legislation under consideration in the House Fossil Fuels Subcommittee which would substitute legislative fiat for negotiations concerning the price of imported gas. We are concerned that, after achieving substantial savings for American consumers and incurring substantial losses ourselves, we are being asked, "What more are you going to do for us today, Canada?" We are particularly concerned about two proposals, first, an amendment to abrogate contracts for imported Canadian gas in favor of supplies from domestic pipelines and, second, proposals to apply to imports at the border the same take-or-pay restrictions

proposed for domestic gas at the wellhead.

The legislation voted out of the Senate Energy Committee this week would abrogate a specific contract to import Canadian gas. Disguised as an attempt to require purchasers to buy equally from affiliated and non-affiliated interstate pipelines, this amendment is in reality an effort to require Pacific Gas and Electric and the California Public Utilities Commission to stop taking or approving Canadian gas imports under a long-term firm contract in favor of gas from domestic pipeline, El Paso Natural Gas, which does not have such a contract or the reserves to back it up. This amendment is nothing more than an attempt by El Paso to legislate a treatment for itself which it could not achieve in the open market. Why is this? The Executive Vice President of Pacific Gas and Electric, Mr. John A. Sproul, in a letter to Energy Committee Chairman James McClure on July 8th, commented on the objectionable provision of the bill now before the Senate:

> Section 501 would purport to put our El Paso and Canadian supplies on an equal footing by requiring that we base our overall purchasing policy of the total supplies available from each source. The percentage of availability test in Section 501 gives no recognition to existing contractual purchase obligations, and completely ignores the higher reliability of our Canadian supply and the very real differences in the service obligations of El Paso and PGT to PGandE.
>
> Our Canadian gas supply has never been curtailed or cut back. In contrast, the El Paso system has been subject to curtailment since the early 1970's, and El Paso was unable to supply PGandE with its firm contractual volume for much of the decade of the 1970's. Today, the major portion of El Paso's delivery arrangement with PGandE is solely a "best efforts" arrangement. Presently, El Paso is firmly committed to supply

PGandE at a level of 420 million cubic feet per day. PGT's firm daily commitment is more than twice as large. Although, as mentioned above, El Paso now has more than 1 billion cubic feet per day of gas available for sale to PGandE, more than 60 percent of this gas is "best efforts" gas, to which no firm delivery commitment presently applies, and for which PGandE is expected to assume all of the risks of future supply shortages.

What is most disturbing about this amendment is that it comes just after Canada has reduced the price of gas delivered to California. For volumes above 50 percent of contract Canadian gas is comparably priced to El Paso today, and will continue to be so next year.

We are likewise concerned with the efforts to put Canadian and domestic gas on what is alleged to be an equal footing with regard to take-or-pay provisions. Some legislative proposals call for applying to take-or-pay at the border the restrictions proposed for take-or-pay at the wellhead for domestic producers. But the cost of gas at the wellhead and at the border cannot be compared. A take-or-pay provision at the wellhead protects only exploration and development costs and is little more than a means of assuring income to the producer. Take-or-pay at the border protects all of costly facilities to explore, produce, gather and transport the gas to the United States border. We note that this legislation does not propose to apply these restrictions to minimum bills outstanding between domestic pipelines, only to pipelines importing natural gas. Quite simply, wellhead take-or-pay provisions cannot be applied at the border. U.S. consumers regularly pay transportation and

gathering costs in pipeline costs of service which would have to be added to the border price to make a wellhead-to-wellhead comparison.

IPAC is aware that an amendment approved by the Senate Energy Committee which might be offered on the Senate floor contains a provision which would price imported gas at the border the same as domestic gas at the wellhead but would add to the border price the transportation cost of service -- an attempt to make a wellhead-to-wellhead comparison of the two supplies. IPAC does not believe the price of imported gas should be legislated and therefore does not endorse this provision but we are mindful that the Senate Committee is trying to make a fair and proper comparison and understands the difference between a border and a wellhead price.

To illustrate the difference between a wellhead and a border price, IPAC has calculated what the true value of the $4.40 border price is compared to a U.S. wellhead price. We deducted from the border price all pipeline and gathering costs which are normally included in transportation costs in the United States and arrived at a wellhead price of $3.23. This is below the price of Section 102 gas in the United States, below the average of all new gas in the United States even after market out and price reductions, and not greatly different from the price at which the United States's best innovator, Transco, is purchasing gas for spot sales into the industrial market. And yet this is gas with at least a 10-year reserve life to back it up.

Finally, with regard to the proposed and drafted legislation, IPAC notes that the Economic Regulatory Administration has commenced a procedure to review and modify its policies regarding imported gas, the objective of which is "to bring about natural gas import arrangements that are based on buyer-seller agreements and are responsive to market conditions."

The ERA has also stated that, following its review, "Revised import authorization criteria will be announced. ERA will then move expeditiously to consider all pending import applications." It will consider whether flowing as well as new gas should be subject to its policy. Thus, in both objective and timeliness the ERA will achieve the results desired by those who would legislate a similar solution. IPAC respectfully suggests that this process is more likely to result in the mutual understanding and cooperation which we regard as critical and that legislation will tend to have the opposite effect.

IPAC is aware of the very real problems facing natural gas consumers in Illinois. In January we met with Chairman and staff of the Illinois Public Service Commission and with officers of People's Gas of Chicago and Natural Gas, Northern Natural and Michigan Wisconsin pipelines, all of which serve Illinois. We have subsequently accepted the price concessions on the PreBuild system which have resulted in substantial savings to Illinois customers receiving gas through PanHandle Eastern and Northern Natural. We have accepted arrangements between TransCanada and Michigan Wisconsin which have reduced prepayments by U.S. consumers and we are hopeful that an arrangement

agreeable to Natural Gas Pipe can be worked out with its supplier, ProGas in Canada.

We also believe the cost of transportation on the Eastern Leg of the PreBuild can be reduced through extending the life of the contract and restructuring the pipeline's debt. We will support these and other adjustments necessary to minimize costs, now that all parties recognize that Alaskan gas will not be flowing to the United States as scheduled.

IPAC wishes to reiterate its intention to play a constructive role and to work closely with those in the United States who recognize that consumers and suppliers are best served when both sides benefit equally. We all know that attempts on either side of the border to dictate terms of trade or development have haunted the relationship long after disputes have passed or been settled. We pledge ourselves to work cooperatively with you for our mutual benefit.